IDAHO CODE

TITLE 28 (1-8)

COMMERCIAL TRANSACTIONS

Current through 2020 Regular Session

MICHIE

IDAHO CODE

CONTAINING THE

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TITLE 28 (1-8)

MICHIE

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PUBLISHER'S NOTE

This publication contains annotations taken from decisions of the Idaho Supreme Court and the Court of Appeals and the appropriate federal courts. These cases will be printed in the following reports: Idaho Reports

Pacific Reporter

Federal Supplement

Federal Reporter

United States Supreme Court Reports, Lawyers' Edition Following is an explanation of the abbreviations of the Court Rules used throughout the Idaho Code.

Idaho R. Civ. P.	Idaho Rules of Civil Procedure
Idaho Evidence Rule	Idaho Rules of Evidence
Idaho R. Crim. P.	Idaho Criminal Rules
Idaho Misdemeanor Crim. Rule	Misdemeanor Criminal Rules
I.I.R.	Idaho Infraction Rules
I.J.R.	Idaho Juvenile Rules
I.C.A.R.	Idaho Court Administrative Rules
Idaho App. R.	Idaho Appellate Rules

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USER'S GUIDE

To assist the legal profession and the layperson in obtaining the maximum benefit from the Idaho Code, a User's Guide has been included in the first volume of this set.

ADJOURNMENT DATES OF SESSIONS OF LEGISLATURE

Article 3, § 22 of the Idaho State Constitution provides: “No act shall take effect until sixty days from the end of the session at which the same shall have been passed, except in case of emergency, which emergency shall be declared in the preamble or in the body of the law.”

Section 67-510 Idaho Code provides: “No act shall take effect until July 1 of the year of the regular session or sixty (60) days from the end of the session at which the same shall have been passed, whichever date occurs last, except in case of emergency, which emergency shall be declared in the preamble or body of the law.

Every joint resolution, unless a different time is prescribed therein, takes effect from its passage.”

This table is given in order that the effective date of acts, not carrying an emergency or which do not specify an effective date, may be determined with a minimum of delay.

Year	Adjournment Date
1921	March 5, 1921
1923	March 9, 1923
1925	March 5, 1925
1927	March 3, 1927
1929	March 7, 1929
1931	March 5, 1931
1931 (E.S.)	March 13, 1931
1933	March 1, 1933
1933 (E.S.)	June 22, 1933
1935	March 8, 1935
1935 (1st E.S.)	March 20, 1935
1935 (2nd E.S.)	July 10, 1935
1935 (3rd E.S.)	July 31, 1936

1937	March 6, 1937
1937 (E.S.)	November 30, 1938
1939	March 2, 1939
1941	March 8, 1941
1943	February 28, 1943
1944 (1st E.S.)	March 1, 1944
1944 (2nd E.S.)	March 4, 1944
1945	March 9, 1945
1946 (1st E.S.)	March 7, 1946
1947	March 7, 1947
1949	March 4, 1949
1950 (E.S.)	February 25, 1950
1951	March 12, 1951
1952 (E.S.)	January 16, 1952
1953	March 6, 1953
1955	March 5, 1955
1957	March 16, 1957
1959	March 9, 1959
1961	March 2, 1961
1961 (1st E.S.)	August 4, 1961
1963	March 19, 1963
1964 (E.S.)	August 1, 1964
1965	March 18, 1965
1965 (1st E.S.)	March 25, 1965
1966 (2nd E.S.)	March 5, 1966
1966 (3rd E.S.)	March 17, 1966
1967	March 31, 1967
1967 (1st E.S.)	June 23, 1967
1968 (2nd E.S.)	February 9, 1968
1969	March 27, 1969
1970	March 7, 1970
1971	March 19, 1971

1971 (E.S.)	April 8, 1971
1972	March 25, 1972
1973	March 13, 1973
1974	March 30, 1974
1975	March 22, 1975
1976	March 19, 1976
1977	March 21, 1977
1978	March 18, 1978
1979	March 26, 1979
1980	March 31, 1980
1981	March 27, 1981
1981 (E.S.)	July 21, 1981
1982	March 24, 1982
1983	April 14, 1983
1983 (E.S.)	May 11, 1983
1984	March 31, 1984
1985	March 13, 1985
1986	March 28, 1986
1987	April 1, 1987
1988	March 31, 1988
1989	March 29, 1989
1990	March 30, 1990
1991	March 30, 1991
1992	April 3, 1992
1992 (E.S.)	July 28, 1992
1993	March 27, 1993
1994	April 1, 1994
1995	March 17, 1995
1996	March 15, 1996
1997	March 19, 1997
1998	March 23, 1998
1999	March 19, 1999

2000	April 5, 2000
2001	March 30, 2001
2002	March 15, 2002
2003	May 3, 2003
2004	March 20, 2004
2005	April 6, 2005
2006	April 11, 2006
2006 (E.S)	August 25, 2006
2007	March 30, 2007
2008	April 2, 2008
2009	May 8, 2009
2010	March 29, 2010
2011	April 7, 2011
2012	March 29, 2012
2013	April 4, 2013
2014	March 20, 2014
2015	April 11, 2015
2015 (E.S.)	May 18, 2015
2016	March 25, 2016
2017	March 29, 2017
2018	March 28, 2018
2019	April 11, 2019
2020	March 20, 2020

Title 28
COMMERCIAL TRANSACTIONS

Chapter

Chapter 1
UNIFORM COMMERCIAL CODE — GENERAL PROVISIONS

Part 1. General Provisions

Part 2. General Definitions and Principles of Interpretation

Part 3. Territorial Applicability and General Rules

Part 1
General Provisions

Idaho Code § 28-1-101

§ 28-1-101. Short titles. — (a) This title shall be known and may be cited as the Uniform Commercial Code.

(b) This chapter may be cited as "Uniform Commercial Code — General Provisions."

History.

1967, ch. 161, § 1-101, p. 351; am. 2004, ch. 43, § 2, p. 136.

STATUTORY NOTES

Compiler's Notes.

The official comments in chapters 1 to 12 of this title are copyrighted by the National Conference of Commissioners of Uniform State Laws and the American Law Institute and are reproduced by permission.

Although subsection (a) of this section states that this title may be cited as the uniform commercial code, in fact, only chapters 1 through 10 and 12 are derived from the model uniform commercial code.

In some instances the subsection, subdivision and other designations in the Idaho version of a section of the Uniform Commercial Code are different than those of the official version. For instance, § 28-3-103 contains subsections (1), (2), (3) and (4) with subsection (1) containing subdivisions (a) to (k). In the uniform version of this section, section 3-102, contains subsections (a), (b), (c) and (d) with subsection (a) containing subdivisions (1) to (11). Therefore, a reference in the official comments to subsection (a) (7) would be a reference to subsection (1) (g) in the Idaho version. Also, the reference in the official comments to "Article" should be translated as "Chapter" for the Idaho Code.

CASE NOTES

Cited Adair v. Freeman, 92 Idaho 773, 451 P.2d 519 (1969); B & M Whsle. Co. v. Anchor Ranch, Inc., 96 Idaho 518, 531 P.2d 1163 (1975); Whitworth v. Krueger, 98 Idaho 65, 558 P.2d 1026 (1976); Everton v. Blair, 99 Idaho 14, 576 P.2d 585 (1978); Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); American Triticale, Inc. v. Nytco Servs., Inc., 664 F.2d 1136 (9th Cir. 1981).

RESEARCH REFERENCES

Am. Jur. 2d. — 68A Am. Jur. 2d, Secured Transactions, § 1 et seq.

ALR. — What constitutes, under the Uniform Negotiable Instruments Law or Commercial Code, a reasonable time for taking a demand instrument, so as to support the taker's status as holder in due course. 10 A.L.R.3d 1199.

Liability on implied warranties in sale of used motor vehicle. 22 A.L.R.3d 1387.

Consignment transactions under the Uniform Commercial Code. 40 A.L.R.3d 1078.

Measure of recovery where buyer repudiates contract for goods to be manufactured to special order, before completion of manufacture. 42 A.L.R.3d 182.

Priorities as between vendor's lien and subsequent title or security interest obtained in another state to which vehicle was removed. 42 A.L.R.3d 1168.

Duty of pledgee of commercial paper as to its enforcement or collection. 45 A.L.R.3d 248.

Application of warranty provisions of Uniform Commercial Code to bailments. 48 A.L.R.3d 668.

Official Comment

Source: Former Section 1-101.

Changes from former law: Subsection (b) is new. It is added in order to make the structure of Article 1 parallel with that of the other articles of the

Uniform Commercial Code.

1. Each other article of the Uniform Commercial Code (except Articles 10 and 11) may also be cited by its own short title. See Sections 2-101, 2A-101 [12-101], 3-101, 4-101, 4A-101, 5-101, 6-101, 7-101, 8-101, and 9-101.

§ 28-1-102. Scope of chapter. — This chapter applies to a transaction to the extent that it is governed by another chapter of the uniform commercial code.

History.

I.C., § 28-1-102, as added by 2004, ch. 43, § 3, p. 136.

STATUTORY NOTES

Compiler's Notes.

Former section 28-1-102, which comprised S.L. 1967, ch. 161, § 1-102, was amended and redesignated as § 28-1-103 in 2004.

Official Comment Source: New.

1. This section is intended to resolve confusion that has occasionally arisen as to the applicability of the substantive rules in this article. This section makes clear what has always been the case — the rules in Article 1 apply to transactions to the extent that those transactions are governed by one of the other articles of the Uniform Commercial Code. See also Comment 1 to Section 1-301.

§ 28-1-103. Construction of uniform commercial code to promote its purposes and policies — Applicability of supplemental principles of law. — (a) The uniform commercial code shall be liberally construed and applied to promote its underlying purposes and policies, which are:

(1) To simplify, clarify, and modernize the law governing commercial transactions; (2) To permit the continued expansion of commercial practices through custom, usage, and agreement of the parties; and (3) To make uniform the law among the various jurisdictions.

(b) Unless displaced by the particular provisions of the uniform commercial code, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.

History.

1967, ch. 161, § 1-102; am. and redesig. 2004, ch. 43, § 5, p. 136.

STATUTORY NOTES

Prior Laws.

Former § 28-1-103, which comprised 1967, ch. 161, § 1-103, p. 351, was repealed by S.L. 2004, ch. 43, § 4. The contents of former § 28-1-103 can now be found in subsection (b) of this section.

Compiler's Notes.

This section was formerly codified as § 28-1-102.

CASE NOTES

Application.

Since the implied warranty provisions of the Uniform Commercial Code are considered statements of public policy, extending these provisions to apply by analogy to lease transactions is proper under appropriate circumstances and in conformity with the liberal spirit of the code. All-States Leasing Co. v. Bass, 96 Idaho 873, 538 P.2d 1177 (1975).

Common law mistake doctrine was not inconsistent with § 28-12-202 and could be applied to transactions governed by the statute. Posey v. Ford Motor Credit Co., 141 Idaho 477, 111 P.3d 162 (Ct. App. 2005).

Fraud.

Lessee has no claim of fraud in the inducement under the Uniform Commercial Code, where any misrepresentation by the dealer regarding the warranty did not substantially impair the value of the leased truck. Mickelsen v. Broadway Ford, Inc., 153 Idaho 149, 280 P.3d 176 (2012).

Photocopied Documents.

This section requires recognition of the use of photocopied documents as part of modern commercial transactions. J.K. Merrill & Son v. Carter, 108 Idaho 749, 702 P.2d 787 (1985).

Purpose.

Severing contracts into various parts, attempting to label each as goods or nongoods, and applying different law to each separate part clearly contravenes the UCC's declared purpose to simplify, clarify and modernize the law governing commercial transactions. Pittsley v. Houser, 125 Idaho 820, 875 P.2d 232 (Ct. App. 1994).

Cited Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977); Mercantile Stores Co. v. Idaho First Nat'l Bank, 102 Idaho 820, 641 P.2d 1007 (Ct. App. 1982); Mix v. Gem Investors, Inc., 103 Idaho 355, 647 P.2d 811 (Ct. App. 1982); Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983); Idaho Bank & Trust Co. v. Cargill, Inc., 105 Idaho 83, 665 P.2d 1093 (Ct. App. 1983); First Sec. Bank v. Mountain View Equip. Co., 112 Idaho 158, 730 P.2d 1078 (Ct. App. 1986); Idaho First Nat'l Bank v. David Steed &

Assocs., 121 Idaho 356, 825 P.2d 79 (1992); Jen-Rath Co. v. KIT Mfg. Co., 137 Idaho 330, 48 P.3d 659 (2002).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 104 et seq.

15A Am. Jur. 2d, Commercial Code, § 15 et seq.

67 Am. Jur. 2d, Sales, §§ 1 to 4.

68A Am. Jur. 2d, Secured Transactions, § 1 et seq.

Official Comment

Source: Former Section 1-102 (1)-(2); Former Section 1-103.

Changes from former law: This section is derived from subsections (1) and (2) of former Section 1-102 and from former Section 1-103. Subsection (a) of this section combines subsections (1) and (2) of former Section 1-102. Except for changing the form of reference to the Uniform Commercial Code and minor stylistic changes, its language is the same as subsections (1) and (2) of former Section 1-102. Except for changing the form of reference to the Uniform Commercial Code and minor stylistic changes, subsection (b) of this section is identical to former Section 1-103. The provisions have been combined in this section to reflect the interrelationship between them.

1. The Uniform Commercial Code is drawn to provide flexibility so that, since it is intended to be a semi-permanent and infrequently-amended piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in the Uniform Commercial Code to be applied by the courts in the light of unforeseen and new circumstances and practices. The proper construction of the Uniform Commercial Code requires, of course, that its interpretation and application be limited to its reason.

Even prior to the enactment of the Uniform Commercial Code, courts were careful to keep broad acts from being hampered in their effects by later acts of limited scope. See *Pacific Wool Growers v. Draper & Co.*, 158 Or. 1, 73 P.2d 1391 (1937), and compare Section 1-104. The courts have

often recognized that the policies embodied in an act are applicable in reason to subject-matter that was not expressly included in the language of the act, *Commercial Nat. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co.,* 239 U.S. 520, 36 S. Ct. 194, 60 L. Ed. 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature), and did the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. *Agar v. Orda,* 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods "other than things in action.") They implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They disregarded a statutory limitation of remedy where the reason of the limitation did not apply. *Fiterman v. J. N. Johnson & Co.,* 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed). Nothing in the Uniform Commercial Code stands in the way of the continuance of such action by the courts.

The Uniform Commercial Code should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Uniform Commercial Code as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. Applicability of supplemental principles of law. Subsection (b) states the basic relationship of the Uniform Commercial Code to supplemental bodies of law. The Uniform Commercial Code was drafted against the backdrop of existing bodies of law, including the common law and equity, and relies on those bodies of law to supplement its provisions in many important ways. At the same time, the Uniform Commercial Code is the primary source of commercial law rules in areas that it governs, and its rules represent choices made by its drafters and the enacting legislatures about the appropriate policies to be furthered in the transactions it covers. Therefore, while principles of common law and equity may *supplement* provisions of the Uniform Commercial Code, they may not be used to *supplant* its provisions, or the purposes and policies those provisions reflect,

unless a specific provision of the Uniform Commercial Code provides otherwise. In the absence of such a provision, the Uniform Commercial Code preempts principles of common law and equity that are inconsistent with either its provisions or its purposes and policies.

The language of subsection (b) is intended to reflect both the concept of supplementation and the concept of preemption. Some courts, however, had difficulty in applying the identical language of former Section 1-103 to determine when other law appropriately may be applied to supplement the Uniform Commercial Code, and when that law has been displaced by the Code. Some decisions applied other law in situations in which that application, while not inconsistent with the text of any particular provision of the Uniform Commercial Code, clearly was inconsistent with the underlying purposes and policies reflected in the relevant provisions of the Code. *See, e.g., Sheerbonnet, Ltd. v. American Express Bank, Ltd.*, 951 F. Supp. 403 (S.D.N.Y. 1995). In part, this difficulty arose from Comment 1 to former Section 1-103, which stated that "this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act." The "explicitly displaced" language of that Comment did not accurately reflect the proper scope of Uniform Commercial Code preemption, which extends to displacement of other law that is inconsistent with the purposes and policies of the Uniform Commercial Code, as well as with its text.

3. Application of subsection (b) to statutes. The primary focus of Section 1-103 is on the relationship between the Uniform Commercial Code and principles of common law and equity as developed by the courts. State law, however, increasingly is statutory. Not only are there a growing number of state statutes addressing specific issues that come within the scope of the Uniform Commercial Code, but in some States many general principles of common law and equity have been codified. When the other law relating to a matter within the scope of the Uniform Commercial Code is a statute, the principles of subsection (b) remain relevant to the court's analysis of the relationship between that statute and the Uniform Commercial Code, but other principles of statutory interpretation that specifically address the interrelationship between statutes will be relevant as well. In some situations, the principles of subsection (b) still will be determinative. For example, the mere fact that an equitable principle is

stated in statutory form rather than in judicial decisions should not change the court's analysis of whether the principle can be used to supplement the Uniform Commercial Code — under subsection (b), equitable principles may supplement provisions of the Uniform Commercial Code only if they are consistent with the purposes and policies of the Uniform Commercial Code as well as its text. In other situations, however, other interpretive principles addressing the interrelationship between statutes may lead the court to conclude that the other statute is controlling, even though it conflicts with the Uniform Commercial Code. This, for example, would be the result in a situation where the other statute was specifically intended to provide additional protection to a class of individuals engaging in transactions covered by the Uniform Commercial Code.

4. Listing not exclusive. The list of sources of supplemental law in subsection (b) is intended to be merely illustrative of the other law that may supplement the Uniform Commercial Code, and is not exclusive. No listing could be exhaustive. Further, the fact that a particular section of the Uniform Commercial Code makes express reference to other law is not intended to suggest the negation of the general application of the principles of subsection (b). Note also that the word "bankruptcy" in subsection (b), continuing the use of that word from former Section 1-103, should be understood not as a specific reference to federal bankruptcy law but, rather as a reference to general principles of insolvency, whether under federal or state law.

§ 28-1-104. Construction against implied repeal. — The uniform commercial code being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

History.

1967, ch. 161, § 1-104, p. 351; am. 2004, ch. 43, § 6, p. 136.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 24.

Official Comment Source: Former Section 1-104.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1-104.

1. This section embodies the policy that an act that bears evidence of carefully considered permanent regulative intention should not lightly be regarded as impliedly repealed by subsequent legislation. The Uniform Commercial Code, carefully integrated and intended as a uniform codification of permanent character covering an entire "field" of law, is to be regarded as particularly resistant to implied repeal.

§ 28-1-105. Severability. — If any provision or clause of the uniform commercial code or its application to any person or circumstance is held invalid, the invalidity shall not affect other provisions or applications of the uniform commercial code which can be given effect without the invalid provision or application, and to this end the provisions of the uniform commercial code are severable.

History.

1967, ch. 161, § 1-108, p. 351; am. and redesig. 2004, ch. 43, § 7, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-108.

Former § 28-1-105 has been recodified as § 28-1-301(b).

Official Comment Source: Former Section 1-108.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1-108.

1. This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

§ 28-1-106. Use of singular and plural — Gender. — In the uniform commercial code, unless the statutory context otherwise requires:

(1) Words in the singular number include the plural, and those in the plural include the singular; and (2) Words of any gender also refer to any other gender.

History.

I.C., § 28-1-106, as added by 2004, ch. 43, § 8, p. 136.

STATUTORY NOTES

Compiler's Notes.

Former § 28-1-106 has been recodified as § 28-1-305.

Official Comment

Source: Former Section 1-102(5). See also 1 U.S.C. Section 1.

Changes from former law: Other than minor stylistic changes, this section is identical to former Section 1-102(5).

1. This section makes it clear that the use of singular or plural in the text of the Uniform Commercial Code is generally only a matter of drafting style — singular words may be applied in the plural, and plural words may be applied in the singular. Only when it is clear from the statutory context that the use of the singular or plural does not include the other is this rule inapplicable. *See, e.g.,* Section 9-322.

§ 28-1-107. Section captions. — Section captions are part of the uniform commercial code.

History.

I.C., § 28-1-107, as added by 2004, ch. 43, § 9, p. 136.

STATUTORY NOTES

Compiler's Notes.

Former § 28-1-107 has been recodified as § 28-1-306.

Official Comment Source: Former Section 1-109.

Changes from former law: None.

1. Section captions are a part of the text of the Uniform Commercial Code, and not mere surplusage. This is not the case, however, with respect to subsection headings appearing in Article 9. See Comment 3 to Section 9-101 ("subsection headings are not a part of the official text itself and have not been approved by the sponsors.").

§ 28-1-108. Relation to electronic signatures in global and national commerce act. — This chapter modifies, limits, and supersedes the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. section 7001 et seq., except that nothing in this chapter modifies, limits, or supersedes section 7001(c) of that act or authorizes electronic delivery of any of the notices described in section 7003(b) of that act.

History.

I.C., § 28-1-108, as added by 2004, ch. 43, § 10, p. 136.

STATUTORY NOTES

Compiler's Notes.

Former § 28-1-108 has been recodified as § 28-1-105.

Official Comment Source: New.

1. The federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. Section 7001 *et seq*., became effective in 2000. Section 102(a) of that Act provides that a State statute may modify, limit, or supersede the provisions of Section 101 of that Act with respect to state law if such statute, *inter alia,* specifies the alternative procedures or requirements for the use or acceptance (or both) of electronic records or electronic signatures to establish the legal effect, validity, or enforceability of contracts or other records, and (i) such alternative procedures or requirements are consistent with Titles I and II of that Act, (ii) such alternative procedures or requirements do not require, or accord greater legal status or effect to, the implementation or application of a specific technology or technical specification for performing the functions of creating, storing, generating, receiving, communicating, or authenticating electronic records or electronic signatures; and (iii) if enacted or adopted after the date of the enactment of that Act, makes specific reference to that Act. Article 1 fulfills the first two of those three criteria; this Section fulfills the third criterion listed above.

2. As stated in this section, however, Article 1 does not modify, limit, or supersede Section 101(c) of the Electronic Signatures in Global and National Commerce Act (requiring affirmative consent from a consumer to electronic delivery of transactional disclosures that are required by state law to be in writing); nor does it authorize electronic delivery of any of the notices described in Section 103(b) of that Act.

Idaho Code Pt. 2

Part 2
General Definitions and Principles of Interpretation

Idaho Code § 28-1-201

§ 28-1-201. General definitions. — (a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other chapters of the uniform commercial code that apply to particular chapters or parts thereof, have the meanings stated.

(b) Subject to definitions contained in other articles of the uniform commercial code that apply to particular articles or parts thereof:

(1) "Action," in the sense of a judicial proceeding, includes recoupment, counterclaim, set-off, suit in equity, and any other proceeding in which rights are determined.

(2) "Aggrieved party" means a party entitled to pursue a remedy.

(3) "Agreement," as distinguished from "contract," means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing or usage of trade as provided in section 28-1-303, Idaho Code.

(4) "Bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company.

(5) "Bearer" means a person in control of a negotiable electronic document of title or a person in possession of a negotiable instrument, negotiable tangible document of title, or certificated security that is payable to bearer or indorsed in blank.

(6) "Bill of lading" means a document of title evidencing the receipt of goods for shipment issued by a person engaged in the business of directly or indirectly transporting or forwarding goods. The term does not include a warehouse receipt.

(7) "Branch" includes a separately incorporated foreign branch of a bank.

(8) “Burden of establishing” a fact means the burden of persuading the trier of fact that the existence of the fact is more probable than its nonexistence.

(9) “Buyer in ordinary course of business” means a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawnbroker, in the business of selling goods of that kind. A person buys goods in the ordinary course if the sale to the person comports with the usual or customary practices in the kind of business in which the seller is engaged or with the seller’s own usual or customary practices. A person that sells oil, gas or other minerals at the wellhead or minehead is a person in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash, by exchange of other property, or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under chapter 2, title 28, Idaho Code, may be a buyer in ordinary course of business. “Buyer in ordinary course of business” does not include a person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) “Conspicuous,” with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it. Whether a term is “conspicuous” or not is a decision for the court. Conspicuous terms include the following:

(A) A heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and

(B) Language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from the surrounding text of the same size by symbols or other marks that call attention to the language.

(11) “Consumer” means an individual who enters into a transaction primarily for personal, family, or household purposes.

(12) “Contract,” as distinguished from “agreement,” means the total legal obligation that results from the parties’ agreement as determined by the uniform commercial code as supplemented by any other applicable laws.

(13) “Creditor” includes a general creditor, a secured creditor, a lien creditor, and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity, and an executor or administrator of an insolvent debtor’s or assignor’s estate.

(14) “Defendant” includes a person in the position of defendant in a counterclaim, cross-claim, or third-party claim.

(15) “Delivery,” with respect to an electronic document of title means voluntary transfer of control and with respect to an instrument, a tangible document of title, or chattel paper, means voluntary transfer of possession.

(16) “Document of title” means a record (i) that in the regular course of business or financing is treated as adequately evidencing that the person in possession or control of the record is entitled to receive, control, hold, and dispose of the record and the goods the record covers and (ii) that purports to be issued by or addressed to a bailee and to cover goods in the bailee’s possession which are either identified or are fungible portions of an identified mass. The term includes a bill of lading, transport document, dock warrant, dock receipt, warehouse receipt, and order for delivery of goods. An electronic document of title means a document of title evidenced by a record consisting of information stored in an electronic medium. A tangible document of title means a document of title evidenced by a record consisting of information that is inscribed on a tangible medium.

(17) “Fault” means a default, breach, or wrongful act or omission.

(18) “Fungible goods” means:

(A) Goods of which any unit, by nature or usage of trade, is the equivalent of any other like unit; or

(B) Goods that by agreement are treated as equivalent.

(19) “Genuine” means free of forgery or counterfeiting.

(20) “Good faith” means honesty in fact in the conduct or transaction concerned.

(21) “Holder” means:

(A) The person in possession of a negotiable instrument that is payable either to bearer or to an identified person that is the person in possession;

(B) The person in possession of a negotiable tangible document of title if the goods are deliverable either to bearer or to the order of the person in possession; or

(C) The person in control of a negotiable electronic document of title.

(22) “Insolvency proceeding” includes an assignment for the benefit of creditors or other proceeding intended to liquidate or rehabilitate the estate of the person involved.

(23) “Insolvent” means:

(A) Having generally ceased to pay debts in the ordinary course of business other than as a result of bona fide dispute;

(B) Being unable to pay debts as they become due; or

(C) Being insolvent within the meaning of federal bankruptcy law.

(24) “Money” means a medium of exchange currently authorized or adopted by a domestic or foreign government. The term includes a monetary unit of account established by an intergovernmental organization or by agreement between two (2) or more countries.

(25) “Organization” means a person other than an individual.

(26) “Party,” as distinguished from “third party,” means a person that has engaged in a transaction or made an agreement subject to the uniform commercial code.

(27) “Person” means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency, or instrumentality, public corporation, or any other legal or commercial entity.

(28) “Present value” means the amount as of a date certain of one (1) or more sums payable in the future, discounted to the date certain by use of either an interest rate specified by the parties if that rate is not manifestly unreasonable at the time the transaction is entered into or, if an interest rate is not so specified, a commercially reasonable rate that takes into account the facts and circumstances at the time the transaction is entered into.

(29) “Purchase” means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift, or any other voluntary transaction creating an interest in property.

(30) “Purchaser” means a person that takes by purchase.

(31) “Record” means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(32) “Remedy” means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(33) “Representative” means a person empowered to act for another, including an agent, an officer of a corporation or association, and a trustee, executor, or administrator of an estate.

(34) “Rights” includes remedy.

(35) “Security interest” means an interest in personal property or fixtures which secures payment or performance of an obligation. “Security interest” includes any interest of a consignor and a buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to chapter 9, title 28, Idaho Code. “Security interest” does not include the special property interest of a buyer of goods on identification of those goods to a contract for sale under section 28-2-401, Idaho Code, but a buyer may also acquire a “security interest” by complying with chapter 9, title 28, Idaho Code. Except as otherwise provided in section 28-2-505, Idaho Code, the right of a seller or lessor of goods under chapter 2 or chapter 12, title 28, Idaho Code, to retain or acquire possession of the goods is not a “security interest,” but a seller or lessor may also acquire a “security interest” by complying with chapter 9, title 28, Idaho Code. The retention or reservation of title by a seller of

goods notwithstanding shipment or delivery to the buyer under section 28-2-401, Idaho Code, is limited in effect to a reservation of a "security interest." Whether a transaction in the form of a lease creates a "security interest" is determined pursuant to section 28-1-203, Idaho Code.

(36) "Send" in connection with a writing, record, or notice means:

(A) To deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and, in the case of an instrument, to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances; or

(B) In any other way to cause to be received any record or notice within the time it would have arrived if properly sent.

(37) "Signed" includes using any symbol executed or adopted with present intention to adopt or accept a writing.

(38) "State" means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(39) "Surety" includes a guarantor or other secondary obligor.

(40) "Term" means a portion of an agreement that relates to a particular matter.

(41) "Unauthorized signature" means a signature made without actual, implied, or apparent authority. The term includes a forgery.

(42) "Warehouse receipt" means a document of title issued by a person engaged in the business of storing goods for hire.

(43) "Written" or "writing" includes printing, typewriting, or any other intentional reduction to tangible form.

History.

I.C., § 28-1-201, as added by 2004, ch. 309, § 2, p. 867.

STATUTORY NOTES

Prior Laws.

Former § 28-1-201, which comprised 1967, ch. 161, § 1-201, p. 351; am. 1979, ch. 299, § 1, p. 781; am. 1984, ch. 88, § 1, p. 183; am. 1993, ch. 287, § 3, p. 977; am. 1993, ch. 288, § 48, p. 1019; am. 2001, ch. 208, § 4, p. 704; am. 2004, ch. 42, § 3; am. 2004, ch. 43, § 11, was repealed by S.L. 2004, ch. 309 § 1.

CASE NOTES

Agreement.

Where at the onset of the parties' transaction, contractor informed supplier that third party presented a risk of nonpayment, and supplier agreed to provide "priced-out" invoices at delivery in order to allow contractor to immediately obtain payment from third party, but supplier failed to properly tender the goods by delivering them without the requisite priced-out invoices, and supplier told contractor to go ahead and unload the materials without the pricing information, based upon this conduct, and from the surrounding circumstances, the magistrate reasonably could construe contractor's unequivocal refusal to be responsible without the pricing information, followed by supplier's authorization to unload the materials, as supplier's assent, or acquiescence, to contractor's proposed new terms, i.e., that contractor would not be liable if he could not collect from third party. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

In the situation where farmer bought certified potato seed from dealer and seed was later found to be infected by bacterial ring rot, because factual questions remained as to whether there were any terms in the parties' agreement excluding warranties or limiting remedies and as to whether there was an applicable course of dealing or trade usage limiting remedies, the lower court's order denying summary judgment on this issue was affirmed. Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995).

Cancellation of PreExisting Debt.

Where the consideration given by the buyer of a farm disc from a consignment exchange was cancellation of a preexisting debt owed to him by the exchange, the buyer was not a "buyer in ordinary course of business." Seitz v. Stecklein, 111 Idaho 364, 723 P.2d 908 (Ct. App. 1986).

Conspicuous.

In a products liability action for personal injury and property damage resulting from a single vehicle accident, where the trial court instructed the jury to decide whether disclaimer of implied and express warranties contained in the conditional sales contract was conspicuous, no prejudice resulted by the trial court's erroneous submission of that question to the jury in view of determination on appeal that the disclaimer was not conspicuous. Farmer v. International Harvester Co., 97 Idaho 742, 553 P.2d 1306 (1976).

A disclaimer clause would not be ruled ineffective to exclude implied warranties of merchantability and fitness for a particular purpose where the disclaimer was conspicuous, was not part of the small print on the signature page, and there was insufficient evidence that the buyer was directed to ignore it. Myers v. A.O. Smith Harvestore Prods., Inc., 114 Idaho 432, 757 P.2d 695 (Ct. App. 1988).

This section says that disclaimers in "contrasting" type are conspicuous; the statute does not say the type must be both contrasting and larger. Therefore, the fact that the disclaimer was under the letterhead, but above the body of the contract, did not detract from its conspicuousness; on the contrary, it amplified its visibility and increased the likelihood of discovery. Clements Farms, Inc. v. Ben Fish & Son, 120 Idaho 185, 814 P.2d 917 (1991).

Construction with Other Statutes.

Lease-purchase agreements qualifying under § 28-36-102(5) are not subject to the "true lease" versus "disguised credit sale" debate which flows under subsection (37) [now (35)] of this section. In re Stellman, 237 Bankr. 759 (Bankr. D. Idaho 1999).

Section 28-36-103(1)(c) states that the laws relating to security interests, as defined in § 28-1-201, do not apply to lease-purchase agreements, but since it does not purport to repeal that section, but only to make the Lease-Purchase Agreement Act (see § 28-36-101) inapplicable to certain contracts, the provisions are not irreconcilably in conflict. In re Stellman, 237 Bankr. 759 (Bankr. D. Idaho 1999).

Course of Dealing.

In determining how a maturity clause in a loan agreement should be interpreted, the trial court was correct in refusing to consider course of dealing, where the lender's conduct asserted by the borrower was "subsequent conduct" rather than "previous conduct." Idaho First Nat'l Bank v. David Steed & Assocs., 121 Idaho 356, 825 P.2d 79 (1992).

Good Faith.

Nothing in the definitions of good faith, subsection (19) [now (20)] of this section and § 28-2-103(1)(b), imposes an implicit requirement for a

seller to match the lowest price available. Harvey v. Fearless Farris Whsle., Inc., 589 F.2d 451 (9th Cir. 1979).

Installment Sales Contracts.

An agreement purporting to lease cattle could not be brought within the scope of § 25-2001 by entitling it a "lease" when it was commercially identical to an installment sales contract. Whitworth v. Krueger, 98 Idaho 65, 558 P.2d 1026 (1976).

Where receivers of cattle had the option at the expiration of the "lease" term to purchase for the sum of $10.00 cattle which the parties had anticipated at the beginning of the term would be worth over $10,000 at the end of the term, the agreement between the parties was one intended for security. Whitworth v. Krueger, 98 Idaho 65, 558 P.2d 1026 (1976).

Subdivision (37) [now (35)] brings under its terms all agreements, regardless of their title, which are commercially indistinguishable from installment sales contracts. Whitworth v. Krueger, 98 Idaho 65, 558 P.2d 1026 (1976).

Knowledge.

In a suit brought by seller of fruit packing equipment alleging a priority interest in machinery affixed to real property which was the subject of a mortgage foreclosure, where the subsequent purchaser at the foreclosure sale had agreed to pay rent for use of the machinery before default on the mortgage, and where the record title holder of the property had contracted for and consented to the machinery being affixed to the real estate, the subsequent purchaser did not have priority either as subsequent purchaser for value without knowledge or as successor in interest to record owner who had withheld consent to preservation of a security interest. Northwest Equip. Sales Co. v. Western Packers, Inc., 543 F.2d 65 (9th Cir. 1976).

Lease or Sale Agreement.

Seven factors are to be considered in determining whether an agreement is a lease or sale agreement: (1) whether the option price is nominal; (2) whether the lessee obtains equity in the property leased; (3) whether the lessee bears the risk of loss; (4) whether the lessee pays the tax, licensing, and the registration fee; (5) whether the lessor may accelerate payment; (6) whether the property is purchased specifically for lease to the lessee; and

(7) whether the lease contains a disclaimer of warranties. In re Maritt, 155 Bankr. 12 (Bankr. D. Idaho 1993).

Where vehicle was purchased from dealer with the specific purpose of leasing it to debtors, where there was evidence projecting a residual value of $4,000 at the end of the leasing period, which would indicate that the $1,800 purchase price was nominal, where the debtors held an equity interest in the vehicle and where under the agreement the debtors bore the risk of loss to the vehicle and paid the tax, licensing and registration fees, such transaction was a sale and not a lease and thus debtors could not be compelled to assume or reject lease under the provisions of the federal bankruptcy law. In re Maritt, 155 Bankr. 12 (Bankr. D. Idaho 1993).

Notice.

Even though an attorney failed to report information to his client corporation until a certain date, the corporation was charged with notice of the information as of the earlier dates on which the attorney received it. Flying Diamond Corp. v. Pennaluna & Co., 586 F.2d 707 (9th Cir. 1978).

In action for conversion of inventory of debtor against supplier by bank that held perfected security interest where bank officer who visited debtor's business approximately every month stated that he observed no noticeable reduction of inventory and was never notified that the merchandise and inventory were being returned for credit to satisfy an existing debt and that when he visited the business in October, 1980 he found that the business had closed its doors and all its merchandise and inventory had been removed and that it came without warning as debtor was not delinquent on his note, it was incumbent on debtor in response to bank officer's denial of knowledge of return of the inventory, to make a showing in detail as specific as the bank, that bank had such knowledge. First Sec. Bank v. Absco Whse., Inc., 104 Idaho 853, 664 P.2d 281 (Ct. App. 1983).

A party is deemed to have given notice once the notice is mailed; whether it was received or noticed when received is immaterial. Airstream, Inc. v. CIT Fin. Servs., Inc., 111 Idaho 307, 723 P.2d 851 (1986).

Where a health care service company required enrollment of newborns within 30 days of birth, but stated no mandatory method for notification of a child's birth, notice by the insured to his employer's group administrator

was a permissible means of giving notice to the service corporation whether or not the group administrator's function constituted an agency relationship; therefore, when claimant informed employer's bookkeeper about the newborn child and asked what needed to be done to insure coverage he gave notice by a method that was not unreasonable or excluded by the contract and child was included in coverage. Howard v. Blue Cross of Idaho Health Serv., Inc., 114 Idaho 485, 757 P.2d 1204 (Ct. App. 1987).

Organization.

Bankruptcy court held that debtors' operation of a dairy as a sole proprietorship did not fall within the definition of "organization" under this section. In re Wiersma, 283 B.R. 294 (Bankr. D. Idaho 2002), aff'd in part, 324 Bankr. 92 (B.A.P. 9th Cir. 2005).

Party.

A co-maker of a note cannot assert the impairment of collateral defense. Great S.W. Life Ins. Co. v. Frazier, 860 F.2d 896 (9th Cir. 1988).

Present Intention to Authenticate.

The signing of the security agreement by the debtor indicates a present intention to authenticate the document; the fact that the document is later photocopied does not detract from the "present intention to authenticate" at the time of the signing. J.K. Merrill & Son v. Carter, 108 Idaho 749, 702 P.2d 787 (1985).

Purchase Order.

A purchase order, which directed and required the buyer's signature on the reverse side, under disclaimer language written and labelled as a disclaimer in large, bold, capital letters, was conspicuous and the language effectively excluded implied warranties of merchantability and fitness for a particular purpose. Myers v. A.O. Smith Harvestore Prods., Inc., 114 Idaho 432, 757 P.2d 695 (Ct. App. 1988).

Security Interest.

— In General.

Although a security interest cannot attach until there is an agreement, the existence of an agreement creating a security interest does not require the

use of the words “security interest” but may be based on the actions and conduct of the parties. Barney v. Rigby Loan & Inv. Co., 344 F. Supp. 694 (D. Idaho 1972).

A person gives value for rights, including a security interest for a preexisting claim. Barney v. Rigby Loan & Inv. Co., 344 F. Supp. 694 (D. Idaho 1972).

An option to purchase does not by itself make a lease a security agreement, but an agreement which provides that, upon compliance with the terms of the lease, the lessee has the option to become the owner of the property for nominal consideration makes the lease an agreement intended for security regardless of the intent of the parties. Eimco Corp. v. Sims, 100 Idaho 390, 598 P.2d 538 (1979).

Where lessee might have exercised an option to purchase a particular piece of equipment at either of 2 times, once for $16,167.50, a significant sum, and once for $170, a nominal sum, and where his actions prior to default did not indicate an apparent belief his rental payments were accumulating equity or took steps to rectify his default, there was ample evidence for the conclusion that a lease, not a security interest, was intended. Eimco Corp. v. Sims, 100 Idaho 390, 598 P.2d 538 (1979).

An examination of the priority and foreclosure scheme of article 9 demonstrates that absence of knowledge of subordinate security interests could not be a prerequisite for a purchaser to buy property free of encumbrances at a foreclosure sale; for, if absence of knowledge were required, the party whose interest would be undermined would be the secured party who was conducting the sale. Northwest Equip. Sales Co. v. Western Packers, Inc., 623 F.2d 92 (9th Cir. 1980).

Although the seller of various items of fruit packing machinery had retained a security interest to secure the purchase price, a subsequent foreclosure sale of the real property to which the machinery was affixed discharged the security interest held by the seller of the machinery, where the purchase at the foreclosure sale of the real estate and fruit packing machinery was in good faith. Northwest Equip. Sales Co. v. Western Packers, Inc., 623 F.2d 92 (9th Cir. 1980).

Where the small business administration held a security interest in fruit packing machinery under its real estate deed of trust which covered the real property to which the machinery was affixed, and where the SBA had purchased the entire interest of the original mortgagees of the property without knowledge of a purchase money security interest retained by the seller of the machinery, the SBA's interest was prior to the purchase money security interest. Northwest Equip. Sales Co. v. Western Packers, Inc., 623 F.2d 92 (9th Cir. 1980).

Where the evidence was clear that, although a lease agreement did contain some attributes of an installment sales contract, there was no oral or written option to purchase the equipment, and title did not pass to the lessee at the end of the term; and since no other relevant evidence was presented demonstrating that the parties intended the transaction to be anything other than a lease, the trial court properly held that the lease agreement was not a security interest subject to Article 9 of the UCC. W.L. Scott, Inc. v. Madras Aerotech, Inc., 103 Idaho 736, 653 P.2d 791 (1982).

In action for conversion of inventory of debtor against supplier by holder of perfected security interest in inventory, the return of the inventory to the supplier, because it was a major part in value of debtor's business inventory and was transferred to satisfy an existing debt due to supplier, was not in the ordinary course of debtor's business and, therefore was not authorized by the express terms of the security agreement that permitted sale or disposal of collateral only in ordinary course of business. First Sec. Bank v. Absco Whse., Inc., 104 Idaho 853, 664 P.2d 281 (Ct. App. 1983).

— Application of 1993 Amendment.

Because the amendment to subsection (37) [now (35)] of this section was intended to clarify, not change the law, the amendment should be applied to all actions determined after its passage regardless of whether the agreement was entered into before the amendment. In re Bumgardner, 183 Bankr. 224 (Bankr. D. Idaho 1995).

— Lease.

Agreements between the owner of a truck and a trailer and a lessee constituted true leases rather than security agreements in a sales transaction where the agreements expressly stated that the lessee was given no option

to purchase and that lessee had no claim of ownership or any right or interest in the property other than as a lessee. Although other language in the agreement gave lessee an opportunity to purchase the property, this opportunity was restricted, and there was no evidence that lessee would have acquired any equity or interest in the property during the term of the lease as a result of that language. Excel Leasing Co. v. Christensen, 115 Idaho 708, 769 P.2d 585 (Ct. App. 1989).

Where a transaction is denominated a lease, the burden is upon the debtor to demonstrate that the transaction is in fact a disguised security interest, rather than a true lease. In re Zaleha, 159 Bankr. 581 (Bankr. D. Idaho 1993).

Where a transaction must be evaluated on its facts to determine whether it is a true lease or a disguised security interest, the proper standard of evaluation is whether the transaction left the lessor with a meaningful residual interest in the leased property. This incorporates consideration of whether the lessee develops equity in the leased goods, without distracting from other elements of the transaction that may also bear on the central issue of whether the transaction is a true lease. In re Zaleha, 159 Bankr. 581 (Bankr. D. Idaho 1993).

Where truck lease was a true lease rather than a disguised security interest, lessor could require debtor to assume or reject the unexpired lease. In re Zaleha, 159 Bankr. 581 (Bankr. D. Idaho 1993).

Under the newly revised subsection (37) [now (35)] of this section, the vehicle transaction was a true lease, and not a disguised security interest, because the repurchase price was not nominal and the debtors had no equity in the vehicle at the end of the lease term; these being the most important factors in the inquiry under this section. In re Bumgardner, 183 Bankr. 224 (Bankr. D. Idaho 1995).

— Purchase Option.

The inclusion or exclusion of a purchase option does not itself solely determine the existence or absence of a security agreement. Excel Leasing Co. v. Christensen, 115 Idaho 708, 769 P.2d 585 (Ct. App. 1989).

In determining whether an option price is nominal, the proper figure to compare it with is not the actual fair market value of the leased goods at the

time the option arises, but their fair market value at that time as anticipated by the parties when the lease is signed. In re Zaleha, 159 Bankr. 581 (Bankr. D. Idaho 1993).

"Signed."

Either defendant company's business name printed in the heading of its form or the handprinted signature of its agent could satisfy as a signature under this section. Paloukos v. Intermountain Chevrolet Co., 99 Idaho 740, 588 P.2d 939 (1978).

Cited Carpenter v. Payette Valley Coop., 99 Idaho 143, 578 P.2d 1074 (1978); Ogilvie v. Idaho Bank & Trust Co., 99 Idaho 361, 582 P.2d 215 (1978); Andrus v. Zion's First Nat'l Bank, 99 Idaho 724, 588 P.2d 452 (1978); American Triticale, Inc. v. Nytco Servs., Inc., 664 F.2d 1136 (9th Cir. 1981); Treasure Valley Bank v. L.T.S., Inc., 32 Bankr. 910 (Bankr. D. Idaho 1983); Idaho Bank & Trust Co. v. Cargill, Inc., 105 Idaho 83, 665 P.2d 1093 (Ct. App. 1983); Snake River Equip. Co. v. Christensen, 107 Idaho 541, 691 P.2d 787 (Ct. App. 1984); In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989); Newgen v. OK Livestock Exch., 117 Idaho 445, 788 P.2d 846 (Ct. App. 1990); Valley Bank v. Monarch Inv. Co., 118 Idaho 747, 800 P.2d 634 (1990); Idaho First Nat'l Bank v. David Steed & Assocs., 121 Idaho 356, 825 P.2d 79 (1992); Hopkins v. Gutknecht (In re Lewis), 2004 Bankr. LEXIS 2727 (Bankr. D. Idaho Sept. 2, 2004).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, §§ 4, 210.

15A Am. Jur. 2d, Commercial Code, § 5 et seq.

17A Am. Jur. 2d, Contracts, § 1 et seq.

67 Am. Jur. 2d, Sales, § 20 et seq.

68A Am. Jur. 2d, Secured Transactions, § 30 et seq.

Official Comment

Source: Former Section 1-201.

Changes from former law: In order to make it clear that all definitions in the Uniform Commercial Code (not just those appearing in Article 1, as stated in former Section 1-201, but also those appearing in other Articles) do not apply if the context otherwise requires, a new subsection (a) to that effect has been added, and the definitions now appear in subsection (b). The reference in subsection (a) to the "context" is intended to refer to the context in which the defined term is used in the Uniform Commercial Code. In other words, the definition applies whenever the defined term is used unless the context in which the defined term is used in the statute indicates that the term was not used in its defined sense. Consider, for example, Sections 3-103(a)(9) (defining "promise," in relevant part, as "a written undertaking to pay money signed by the person undertaking to pay") and 3-303(a)(1) (indicating that an instrument is issued or transferred for value if "the instrument is issued or transferred for a promise of performance, to the extent that the promise has been performed." It is clear from the statutory context of the use of the word "promise" in Section 3-303(a)(1) that the term was not used in the sense of its definition in Section 3-103(a)(9). Thus, the Section 3-103(a)(9) definition should not be used to give meaning to the word "promise" in Section 3-303(a).

Some definitions in former Section 1-201 have been reformulated as substantive provisions and have been moved to other sections. See Sections 1-202 (explicating concepts of notice and knowledge formerly addressed in Sections 1-201(25)-(27)), 1-204 (determining when a person gives value for rights, replacing the definition of "value" in former Section 1-201(44)), and 1-206 (addressing the meaning of presumptions, replacing the definitions of "presumption" and "presumed" in former Section 1-201(31)). Similarly, the portion of the definition of "security interest" in former Section 1-201(37) which explained the difference between a security interest and a lease has been relocated to Section 1-203.

Two definitions in former Section 1-201 have been deleted. The definition of "honor" in former Section 1-201(21) has been moved to Section 2-103(1)(b), inasmuch as the definition only applies to the use of the word in Article 2. The definition of "telegram" in former Section 1-201(41) has been deleted because that word no longer appears in the definition of "conspicuous."

Other than minor stylistic changes and renumbering, the remaining definitions in this section are as in former Article 1 except as noted below.

1. "Action." Unchanged from former Section 1-201, which was derived from similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act.

2. "Aggrieved party." Unchanged from former Section 1-201.

3. "Agreement." Derived from former Section 1-201. As used in the Uniform Commercial Code the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of the Uniform Commercial Code to displace a stated rule of law. Whether an agreement has legal consequences is determined by applicable provisions of the Uniform Commercial Code and, to the extent provided in Section 1-103, by the law of contracts.

4. "Bank." Derived from Section 4A-104.

5. "Bearer." Unchanged, except in one respect, from former Section 1-201, which was derived from Section 191, Uniform Negotiable Instruments Law. The term bearer applies to negotiable documents of title and has been broadened to include a person in control of an electronic negotiable document of title. Control of an electronic document of title is defined in Article 7 (Section 7-106).

6. "Bill of Lading." Derived from former Section 1-201. The reference to, and definition of, an "airbill" has been deleted as no longer necessary. A bill of lading is one type of document of title as defined in subsection (16). This definition should be read in conjunction with the definition of carrier in Article 7 (Section 7-102).

7. "Branch." Unchanged from former Section 1-201.

8. "Burden of establishing a fact." Unchanged from former Section 1-201.

9. "Buyer in ordinary course of business." Except for minor stylistic changes, identical to former Section 1-201 (as amended in conjunction with

the 1999 revisions to Article 9). The major significance of the phrase lies in Section 2-403 and in the Article on Secured Transactions (Article 9).

The first sentence of paragraph (9) makes clear that a buyer from a pawnbroker cannot be a buyer in ordinary course of business. The second sentence explains what it means to buy "in the ordinary course." The penultimate sentence prevents a buyer that does not have the right to possession as against the seller from being a buyer in ordinary course of business. Concerning when a buyer obtains possessory rights, see Sections 2-502 and 2-716. However, the penultimate sentence is not intended to affect a buyer's status as a buyer in ordinary course of business in cases (such as a "drop shipment") involving delivery by the seller to a person buying from the buyer or a donee from the buyer. The requirement relates to whether *as against the seller* the buyer or one taking through the buyer has possessory rights.

10. "Conspicuous." Derived from former Section 1-201(10). This definition states the general standard that to be conspicuous a term ought to be noticed by a reasonable person. Whether a term is conspicuous is an issue for the court. Subparagraphs (A) and (B) set out several methods for making a term conspicuous. Requiring that a term be conspicuous blends a notice function (the term ought to be noticed) and a planning function (giving guidance to the party relying on the term regarding how that result can be achieved). Although these paragraphs indicate some of the methods for making a term attention-calling, the test is whether attention can reasonably be expected to be called to it. The statutory language should not be construed to permit a result that is inconsistent with that test.

11. "Consumer." Derived from Section 9-102(a)(25).

12. "Contract." Except for minor stylistic changes, identical to former Section 1-201.

13. "Creditor." Unchanged from former Section 1-201.

14. "Defendant." Except for minor stylistic changes, identical to former Section 1-201, which was derived from Section 76, Uniform Sales Act.

15. "Delivery." Derived from former Section 1-201. The reference to certificated securities has been deleted in light of the more specific treatment of the matter in Section 8-301. The definition has been revised to

accommodate electronic documents of title. Control of an electronic document of title is defined in Article 7 (Section 7-106).

16. "Document of title." Derived from former Section 1-201, which was derived from Section 76, Uniform Sales Act. This definition makes explicit that the obligation or designation of a third party as "bailee" is essential to a document of title clearly rejects any such result as obtained in *Hixson v. Ward,* 254 Ill. App. 505 (1929), which treated a conditional sales contract as a document of title. Also the definition is left open so that new types of documents may be included, including documents which gain commercial recognition in the international arena. See UNCITRAL Draft Instrument on the Carriage of Goods By Sea. It is unforeseeable what documents may one day serve the essential purpose now filled by warehouse receipts and bills of lading. The definition is stated in terms of the function of the documents with the intention that any document which gains commercial recognition as accomplishing the desired result shall be included within its scope. Fungible goods are adequately identified within the language of the definition by identification of the mass of which they are a part.

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by shipping companies upon delivery of the goods at the dock, entitling a designated person to be issued a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this section regardless of the name given to the instrument.

The goods must be "described," but the description may be by marks or labels and may be qualified in such a way as to disclaim personal knowledge of the issuer regarding contents or condition. However, baggage and parcel checks and similar "tokens" of storage which identify stored goods only as those received in exchange for the token are not covered by this Article. The definition is broad enough to include an airway bill.

A document of title may be either tangible or electronic. Tangible documents of title should be construed to mean traditional paper documents. Electronic documents of title are documents that are stored in an electronic medium instead of in tangible form. The concept of an electronic medium should be construed liberally to include electronic, digital, magnetic, optical, electromagnetic, or any other current or similar emerging technologies. As to reissuing a document of title in an alternative medium, see Article 7, Section 7-105. Control for electronic documents of title is defined in Article 7 (Section 7-106).

17. "Fault." Derived from former Section 1-201. "Default" has been added to the list of events constituting fault.

18. "Fungible goods." Derived from former Section 1-201. References to securities have been deleted because Article 8 no longer uses the term "fungible" to describe securities. Accordingly, this provision now defines the concept only in the context of goods.

19. "Genuine." Unchanged from former Section 1-201.

20. "Good faith." Former Section 1-201(19) defined "good faith" simply as honesty in fact; the definition contained no element of commercial reasonableness. Initially, that definition applied throughout the Code with only one exception. Former Section 2-103(1)(b) provided that "*in this Article* . . . good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." This alternative definition was limited in applicability in three ways. First, it applied only to transactions within the scope of Article 2. Second, it applied only to merchants. Third, strictly construed it applied only to uses of the phrase "good faith" *in Article 2*; thus, so construed it would not define "good faith" for its most important use — the obligation of good faith imposed by former Section 1-203.

Over time, however, amendments to the Uniform Commercial Code brought the Article 2 merchant concept of good faith (subjective honesty and objective commercial reasonableness) into other Articles. First, Article 2A explicitly incorporated the Article 2 standard. See Section 2A-103(7). Then, other Articles broadened the applicability of that standard by adopting it for all parties rather than just for merchants. *See, e.g.,* Sections 3-103(a)(4), 4A-105(a)(6), 8-102(a)(10), and 9-102(a)(43). All of these

definitions are comprised of two elements — honesty in fact *and* the observance of reasonable commercial standards of fair dealing. Only revised Article 5 defines "good faith" solely in terms of subjective honesty, and only Article 6 and Article 7 are without definitions of good faith. (It should be noted that, while revised Article 6 did not define good faith, Comment 2 to revised Section 6-102 states that "this Article adopts the definition of 'good faith' in Article 1 in all cases, even when the buyer is a merchant.") Given these developments, it is appropriate to move the broader definition of "good faith" to Article 1. Of course, this definition is subject to the applicability of the narrower definition in revised Article 5.

21. "Holder." Derived from former Section 1-201. The definition has been reorganized for clarity and amended to provide for electronic negotiable documents of title.

22. "Insolvency proceedings." Unchanged from former Section 1-201.

23. "Insolvent." Derived from former Section 1-201. The three tests of insolvency — "generally ceased to pay debts in the ordinary course of business other than as a result of a bona fide dispute as to them," "unable to pay debts as they become due," and "insolvent within the meaning of the federal bankruptcy law" — are expressly set up as alternative tests and must be approached from a commercial standpoint.

24. "Money." Substantively identical to former Section 1-201. The test is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

25. "Organization." The former definition of this word has been replaced with the standard definition used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

26. "Party." Substantively identical to former Section 1-201. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to the principal, particular account is taken of that situation.

27. "Person." The former definition of this word has been replaced with the standard definition used in acts prepared by the National Conference of

Commissioners on Uniform State Laws.

28. “Present value.” This definition was formerly contained within the definition of “security interest” in former Section 1-201(37).

29. “Purchase.” Derived from former Section 1-201. The form of definition has been changed from “includes” to “means.”

30. “Purchaser.” Unchanged from former Section 1-201.

31. “Record.” Derived from Section 9-102(a)(69).

32. “Remedy.” Unchanged from former Section 1-201. The purpose is to make it clear that both remedy and right (as defined) include those remedial rights of “self help” which are among the most important bodies of rights under the Uniform Commercial Code, remedial rights being those to which an aggrieved party may resort on its own.

33. “Representative.” Derived from former Section 1-201. Reorganized, and form changed from “includes” to “means.”

34. “Right.” Except for minor stylistic changes, identical to former Section 1-201.

35. “Security Interest.” The definition is the first paragraph of the definition of “security interest” in former Section 1-201, with minor stylistic changes. The remaining portion of that definition has been moved to Section 1-203. Note that, because of the scope of Article 9, the term includes the interest of certain outright buyers of certain kinds of property.

36. “Send.” Derived from former Section 1-201. Compare “notifies”.

37. “Signed.” Derived from former Section 1-201. Former Section 1-201 referred to “intention to authenticate”; because other articles now use the term “authenticate,” the language has been changed to “intention to adopt or accept.” The latter formulation is derived from the definition of “authenticate” in Section 9-102(a)(7). This provision refers only to writings, because the term “signed,” as used in some articles, refers only to writings. This provision also makes it clear that, as the term “signed” is used in the Uniform Commercial Code, a complete signature is not necessary. The symbol may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible situations

can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to adopt or accept the writing.

38. "State." This is the standard definition of the term used in acts prepared by the National Conference of Commissioners on Uniform State Laws.

39. "Surety." This definition makes it clear that "surety" includes all secondary obligors, not just those whose obligation refers to the person obligated as a surety. As to the nature of secondary obligations generally, see Restatement (Third), Suretyship and Guaranty Section 1 (1996).

40. "Term." Unchanged from former Section 1-201.

41. "Unauthorized signature." Unchanged from former Section 1-201.

42. "Warehouse receipt." Derived from former Section 1-201, which was derived from Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included, provided the warehouseman and the depositor of the goods are different persons. The definition makes clear that the receipt must qualify as a document of title under subsection (16).

43. "Written" or "writing." Unchanged from former Section 1-201.

§ 28-1-202. Notice — Knowledge. — (a) Subject to subsection (f) of this section, a person has "notice" of a fact if the person:

(1) Has actual knowledge of it;

(2) Has received a notice or notification of it; or

(3) From all the facts and circumstances known to the person at the time in question, has reason to know that it exists.

(b) "Knowledge" means actual knowledge. "Knows" has a corresponding meaning.

(c) "Discover," "learn," or words of similar import refer to knowledge rather than to reason to know.

(d) A person "notifies" or "gives" a notice or notification to another person by taking such steps as may be reasonably required to inform the other person in ordinary course, whether or not the other person actually comes to know of it.

(e) Subject to subsection (f) of this section, a person "receives" a notice or notification when:

(1) It comes to that person's attention; or

(2) It is duly delivered in a form reasonable under the circumstances at the place of business through which the contract was made or at another location held out by that person as the place for receipt of such communications.

(f) Notice, knowledge, or a notice or notification received by an organization is effective for a particular transaction from the time it is brought to the attention of the individual conducting that transaction and, in any event, from the time it would have been brought to the individual's attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to

communicate information unless the communication is part of the individual's regular duties or the individual has reason to know of the transaction and that the transaction would be materially affected by the information.

History.

I.C., § 28-1-202, as added by 2004, ch. 43, § 12, p. 136.

STATUTORY NOTES

Compiler's Notes.

Former § 28-1-202 has been recodified as § 28-1-307.

Official Comment

Source: Derived from former Section 1-201(25)-(27).

Changes from former law: These provisions are substantive rather than purely definitional. Accordingly, they have been relocated from Section 1-201 to this section. The reference to the "forgotten notice" doctrine has been deleted.

1. Under subsection (a), a person has notice of a fact when, *inter alia*, the person has received a notification of the fact in question.

2. As provided in subsection (d), the word "notifies" is used when the essential fact is the proper dispatch of the notice, not its receipt. Compare "Send." When the essential fact is the other party's receipt of the notice, that is stated. Subsection (e) states when a notification is received.

3. Subsection (f) makes clear that notice, knowledge, or a notification, although "received," for instance, by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

§ 28-1-203. Lease distinguished from security interest. — (a) Whether a transaction in the form of a lease creates a lease or security interest is determined by the facts of each case.

(b) A transaction in the form of a lease creates a security interest if the consideration that the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease and is not subject to termination by the lessee, and:

(1) The original term of the lease is equal to or greater than the remaining economic life of the goods;

(2) The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;

(3) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement; or

(4) The lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration upon compliance with the lease agreement.

(c) A transaction in the form of a lease does not create a security interest merely because:

(1) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;

(2) The lessee assumes risk of loss of the goods;

(3) The lessee agrees to pay, with respect to the goods, taxes, insurance, filing, recording, or registration fees, or service or maintenance costs;

(4) The lessee has an option to renew the lease or to become the owner of the goods;

(5) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the

use of the goods for the term of the renewal at the time the option is to be performed; or

(6) The lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

(d) Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised. Additional consideration is not nominal if:

(1) When the option to renew the lease is granted to the lessee, the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed; or

(2) When the option to become the owner of the goods is granted to the lessee, the price is stated to be the fair market value of the goods determined at the time the option is to be performed.

(e) The "remaining economic life of the goods" and "reasonably predictable" fair market rent, fair market value, or cost of performing under the lease agreement must be determined with reference to the facts and circumstances at the time the transaction is entered into.

History.

I.C., § 28-1-203, as added by 2004, ch. 43, § 13, p. 136.

STATUTORY NOTES

Compiler's Notes.

Former § 28-1-203 has been recodified as § 28-1-304.

CASE NOTES

Illustrative cases.

Sale.

Illustrative Cases.

Trustee was entitled to an order under 11 U.S.C.S. § 542 which required Chapter 7 debtors to turn over items they acquired when they purchased a

plumbing business because the debtors had an ownership interest in the items at the time they declared bankruptcy; although the debtors claimed that the items belonged to a friend who loaned them money so they could buy the plumbing business, and that they were leasing the items from their friend, the evidence supported a finding that the arrangement they had with their friend was a disguised security interest because the debtors would own the items without paying additional compensation once all payments were made. In re Hunt, 540 B.R. 438 (Bankr. D. Idaho 2015).

Sale.

Where a bankruptcy debtor purported to lease restaurant equipment under a lease which provided that the debtor had an option to purchase the equipment for a nominal price after paying the monthly payments for the full lease term, and the putative lessor filed a financing statement to protect its security interest in the equipment, the transaction was a sale rather than a lease. Bankr. Estate of Wing Foods, Inc. v. CCF Leasing Co. (In re Wing Foods), 2010 Bankr. LEXIS 114 (Bankr. D. Idaho Jan. 14, 2010).

Official Comment

Source: Former Section 1-201(37).

Changes from former law: This section is substantively identical to those portions of former Section 1-201(37) that distinguished "true" leases from security interests, except that the definition of "present value" formerly embedded in Section 1-201(37) has been placed in Section 1-201(28).

1. An interest in personal property or fixtures which secures payment or performance of an obligation is a "security interest." See Section 1-201(37). Security interests are sometimes created by transactions in the form of leases. Because it can be difficult to distinguish leases that create security interests from those that do not, this section provides rules that govern the determination of whether a transaction in the form of a lease creates a security interest.

2. One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that created considerable confusion in the courts: what is a lease? The confusion existed, in part, due to the last two

sentences of the definition of security interest in the 1978 Official Text of the Act, Section 1-201(37). The confusion was compounded by the rather considerable change in the federal, state and local tax laws and accounting rules as they relate to leases of goods. The answer is important because the definition of lease determines not only the rights and remedies of the parties to the lease but also those of third parties. If a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee's creditors. "On common law theory, the lessor, since he has not parted with title, is entitled to full protection against the lessee's creditors and trustee in bankruptcy . . . ." 1 G. Gilmore, *Security Interests in Personal Property* Section 3.6, at 76 (1965).

Under pre-UCC chattel security law there was generally no requirement that the lessor file the lease, a financing statement, or the like, to enforce the lease agreement against the lessee or any third party; the Article on Secured Transactions (Article 9) did not change the common law in that respect. Coogan, Leasing and the Uniform Commercial Code, in *Equipment Leasing — Leveraged Leasing* 681, 700 n.25, 729 n.80 (2d ed. 1980). The Article on Leases (Article 2A) did not change the law in that respect, except for leases of fixtures. Section 2A-309. An examination of the common law will not provide an adequate answer to the question of what is a lease. The definition of security interest in Section 1-201(37) of the 1978 Official Text of the Act provided that the Article on Secured Transactions (Article 9) governs security interests disguised as leases, *i.e.*, leases intended as security; however, the definition became vague and outmoded.

Lease is defined in Article 2A as a transfer of the right to possession and use of goods for a term, in return for consideration. Section 2A-103(1)(j). The definition continues by stating that the retention or creation of a security interest is not a lease. Thus, the task of sharpening the line between true leases and security interests disguised as leases continues to be a function of this Article.

This section begins where Section 1-201(35) leaves off. It draws a sharper line between leases and security interests disguised as leases to create greater certainty in commercial transactions.

Prior to enactment of the rules now codified in this section, the 1978 Official Text of Section 1-201(37) provided that whether a lease was intended as security (*i.e*., a security interest disguised as a lease) was to be determined from the facts of each case; however, (a) the inclusion of an option to purchase did not itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee would become, or had the option to become, the owner of the property for no additional consideration, or for a nominal consideration, did make the lease one intended for security.

Reference to the intent of the parties to create a lease or security interest led to unfortunate results. In discovering intent, courts relied upon factors that were thought to be more consistent with sales or loans than leases. Most of these criteria, however, were as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, this section contains no reference to the parties' intent.

Subsections (a) and (b) were originally taken from Section 1(2) of the Uniform Conditional Sales Act (act withdrawn 1943), modified to reflect current leasing practice. Thus, reference to the case law prior to the incorporation of those concepts in this article will provide a useful source of precedent. Gilmore, *Security Law, Formalism and Article 9,* 47 Neb. L. Rev. 659, 671 (1968). Whether a transaction creates a lease or a security interest continues to be determined by the facts of each case. Subsection (b) further provides that a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee (thus correcting early statutory gloss, *e.g., In re Royer's Bakery, Inc*., 1 U.C.C. Rep. Serv. (Callaghan) 342 (Bankr. E.D. Pa. 1963)) and if one of four additional tests is met. The first of these four tests, subparagraph (1), is that the original lease term is equal to or greater than the remaining economic life of the goods. The second of these tests, subparagraph (2), is that the lessee is either bound to renew the lease for the remaining economic life of the goods or to become the owner of the goods. *In re Gehrke Enters*., 1 Bankr. 647, 651-52 (Bankr. W.D. Wis. 1979). The third of these tests, subparagraph (3), is whether the lessee has an option to renew the lease for the remaining economic life of the goods

for no additional consideration or for nominal additional consideration, which is defined later in this section. *In re Celeryvale Transp.*, 44 Bankr. 1007, 1014-15 (Bankr. E.D. Tenn. 1984). The fourth of these tests, subparagraph (4), is whether the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration. All of these tests focus on economics, not the intent of the parties. *In re Berge*, 32 Bankr. 370, 371-73 (Bankr. W.D. Wis. 1983).

The focus on economics is reinforced by subsection (c). It states that a transaction does not create a security interest merely because the transaction has certain characteristics listed therein. Subparagraph (1) has no statutory derivative; it states that a full payout lease does not *per se* create a security interest. *Rushton v. Shea*, 419 F. Supp. 1349, 1365 (D. Del. 1976). Subparagraphs (2) and (3) provide the same regarding the provisions of the typical net lease. *Compare All-States Leasing Co. v. Ochs*, 42 Or. App. 319, 600 P.2d 899 (Ct. App. 1979), *with In re Tillery*, 571 F.2d 1361 (5th Cir. 1978). Subparagraph (4) restates and expands the provisions of the 1978 Official Text of Section 1-201(37) to make clear that the option can be to buy or renew. Subparagraphs (5) and (6) treat fixed price options and provide that fair market value must be determined at the time the transaction is entered into. *Compare Arnold Mach. Co. v. Balls*, 624 P.2d 678 (Utah 1981), *with Aoki v. Shepherd Mach. Co.*, 665 F.2d 941 (9th Cir. 1982).

The relationship of subsection (b) to subsection (c) deserves to be explored. The fixed price purchase option provides a useful example. A fixed price purchase option in a lease does not of itself create a security interest. This is particularly true if the fixed price is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed. A security interest is created only if the option price is nominal and the conditions stated in the introduction to the second paragraph of this subsection are met. There is a set of purchase options whose fixed price is less than fair market value but greater than nominal that must be determined on the facts of each case to ascertain whether the transaction in which the option is included creates a lease or a security interest.

It was possible to provide for various other permutations and combinations with respect to options to purchase and renew. For example,

this section could have stated a rule to govern the facts of *In re Marhoefer Packing Co*., 674 F.2d 1139 (7th Cir. 1982). This was not done because it would unnecessarily complicate the definition. Further development of this rule is left to the courts.

Subsections (d) and (e) provide definitions and rules of construction.

§ 28-1-204. Value. — Except as otherwise provided in chapters 3, 4, 5 and 6, title 28, Idaho Code, a person gives value for rights if the person acquires them:

(1) In return for a binding commitment to extend credit or for the extension of immediately available credit, whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; (2) As security for, or in total or partial satisfaction of, a preexisting claim; (3) By accepting delivery under a preexisting contract for purchase; or (4) In return for any consideration sufficient to support a simple contract.

History.

I.C., § 28-1-204, as added by 2004, ch. 43, § 14, p. 136.

STATUTORY NOTES

Compiler's Notes.

Former § 28-1-204 has been recodified as § 28-1-205.

Chapter 6 of title 28, Idaho Code, referred to in the introductory paragraph, was repealed by S.L. 1993, ch. 288, § 46, effective July 1, 1993.

CASE NOTES

Cited Jen-Rath Co. v. KIT Mfg. Co., 137 Idaho 330, 48 P.3d 659 (2002).

Official Comment

Source: Former Section 1-201(44).

Changes from former law: Unchanged from former Section 1-201, which was derived from Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section 22(1), Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. These provisions are substantive rather than purely definitional.

Accordingly, they have been relocated from former Section 1-201 to this section.

1. All the Uniform Acts in the commercial law field (except the Uniform Conditional Sales Act) have carried definitions of “value.” All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a preexisting claim. Subsections (1), (2), and (4) in substance continue the definitions of “value” in the earlier acts. Subsection (3) makes explicit that “value” is also given in a third situation: where a buyer by taking delivery under a preexisting contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of immediately available credit as value follows the separate definitions in those Articles. See Sections 4-208, 4-209, 3-303. A bank or other financing agency which in good faith makes advances against property held as collateral becomes a bona fide purchaser of that property even though provision may be made for charge-back in case of trouble. Checking credit is “immediately available” within the meaning of this section if the bank would be subject to an action for slander of credit in case checks drawn against the credit were dishonored, and when a charge-back is not discretionary with the bank, but may only be made when difficulties in collection arise in connection with the specific transaction involved.

§ 28-1-205. Reasonable time — Seasonableness. — (a) Whether a time for taking an action required by the uniform commercial code is reasonable depends on the nature, purpose, and circumstances of the action.

(b) An action is taken seasonably if it is taken at or within the time agreed or, if no time is agreed, at or within a reasonable time.

History.

1967, ch. 161, § 1-204, p. 351; am. and redesig. 2004, ch. 43, § 15, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-204.

Former § 28-1-205 has been recodified as § 28-1-303.

CASE NOTES

Rejection in Reasonable Time.

Where inspection of potatoes was completed on Friday and buyer's president orally rejected the crop absolutely and unequivocally on the following Monday, the rejection of the nonconforming goods was accomplished in a reasonable time under this section. G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

Athletic club owners' rejection of a dehumidifier occurred within a reasonable time after delivery, because they needed to operate the dehumidifier in the athletic club to determine whether it conformed to the express warranty that it was fit for that particular purpose. Their continued use of the dehumidifier was necessary to mitigate damages and was not an

act inconsistent with the corporation's ownership. Keller v. Inland Metals All Weather Conditioning, Inc., 139 Idaho 233, 76 P.3d 977 (2003).

Test of Reasonability.

In determining the issue of reasonability, factors such as the nature of the goods to be delivered, the extent of the seller's knowledge of the buyer's intentions, transportation conditions and the nature of the market should be considered. Anderson & Nafziger v. G.T. Newcomb, Inc., 100 Idaho 175, 595 P.2d 709 (1979).

After a buyer and seller entered into a contract for the sale of logs for the construction of a log cabin, and the contract failed to set forth a delivery date, the buyer waited for delivery of a complete log cabin package for over a year after paying the seller 70 percent of the contract price. The buyer then arranged to purchase the balance of logs needed to complete her cabin from another supplier, and the seller was found to have breached the contract by failing to deliver the logs within a reasonable time. Borah v. McCandless, 147 Idaho 73, 205 P.3d 1209 (2009).

Cited Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Jen-Rath Co. v. KIT Mfg. Co., 137 Idaho 330, 48 P.3d 659 (2002).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, §§ 292, 293.

15A Am. Jur. 2d, Commercial Code, § 25.

17A Am. Jur. 2d, Contracts, § 466 et seq.

67 Am. Jur. 2d, Sales, § 230 et seq.

ALR. — What constitutes, under the Uniform Negotiable Instruments Law or Commercial Code, a reasonable time for taking a demand instrument, so as to support the taker's status as holder in due course. 10 A.L.R.3d 1199.

Official Comment

Source: Former Section 1-204(2)-(3).

Changes from former law: This section is derived from subsections (2) and (3) of former Section 1-204. Subsection (1) of that section is now incorporated in Section 1-302(b).

1. Subsection (a) makes it clear that requirements that actions be taken within a "reasonable" time are to be applied in the transactional context of the particular action.

2. Under subsection (b), the agreement that fixes the time need not be part of the main agreement, but may occur separately. Notice also that under the definition of "agreement" (Section 1-201) the circumstances of the transaction, including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.

§ 28-1-206. Presumptions. — Whenever the uniform commercial code creates a "presumption" with respect to a fact, or provides that a fact is "presumed," the trier of fact must find the existence of the fact unless and until evidence is introduced that supports a finding of its nonexistence.

History.

I.C., § 28-1-206, as added by 2004, ch. 43, § 17, p. 136.

STATUTORY NOTES

Prior Laws.

Former § 28-1-206, which comprised 1967, ch. 161, § 1-206, p. 351; am. 1995, ch. 272, § 17, p. 873, was repealed by S.L. 2004, ch. 43, § 16.

Official Comment Source: Former Section 1-201(31).

Changes from former law. None, other than stylistic changes.

1. Several sections of the Uniform Commercial Code state that there is a "presumption" as to a certain fact, or that the fact is "presumed." This section, derived from the definition appearing in former Section 1-201(31), indicates the effect of those provisions on the proof process.

Part 3
Territorial Applicability and General Rules

Idaho Code § 28-1-301

§ 28-1-301. Territorial application of the uniform commercial code — Parties' power to choose applicable law. — (a) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement the uniform commercial code applies to transactions bearing an appropriate relation to this state.

(b) Where one (1) of the following provisions of the uniform commercial code specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law, including the conflict of laws rules, so specified:

Rights of creditors against sold goods. Section 28-2-402, Idaho Code.

Applicability of the chapter on leases. Sections 28-12-105 and 28-12-106, Idaho Code.

Applicability of the chapter on bank deposits and collections. Section 28-4-102, Idaho Code.

Governing law in the part on funds transfers. Section 28-4-638, Idaho Code.

Letters of credit. Section 28-5-116, Idaho Code.

Applicability of the chapter on investment securities. Section 28-8-110, Idaho Code.

Law governing perfection, the effect of perfection or nonperfection, the priority of security interests and agricultural liens. Sections 28-9-301 through 28-9-307, Idaho Code.

History.

1967, ch. 161, § 1-105, p. 351; am. 1991, ch. 135, § 2, p. 295; am. 1993, ch. 287, § 2, p. 977; am. 1993, ch. 288, § 47, p. 1019; am. 1995, ch. 272, §

16, p. 873; am. 1996, ch. 7, § 3, p. 9; am. 2001, ch. 208, § 3, p. 704; am. and redesig. 2004, ch. 43, § 19, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-105.

Section 54 of S.L. 1993, ch. 288 read: "Rights and obligations that arose under Chapter 6, Title 28, Idaho Code, and Section 28-9-111, Idaho Code, before their repeal remain valid and may be enforced as though those statutes had not been repealed."

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

CASE NOTES

Applicable law.

In a dispute over whether a vehicle transaction was a true lease or disguised security interest, Idaho law applied because if the agreement is a security agreement, certificate of title of the vehicle was issued in Idaho and under § 28-9-103, Idaho law would apply, and if the agreement is a true lease, because the debtors resided in Idaho at the time that the agreement became enforceable. In re Bumgardner, 183 Bankr. 224 (Bankr. D. Idaho 1995).

Provision Upheld.

Where parties' agreement provided that their contract should be interpreted, construed and governed by the laws of Florida, where defendants were corporations organized under the laws of Florida, and both maintained their principal place of business in Florida, and where the performance of defendant's obligations under the contract took place, in part, in Florida, district court erred in not applying the choice of law

provision in the parties' contract since Florida bore a reasonable relation to the transaction. Cerami-Kote, Inc. v. Energywave Corp., 116 Idaho 56, 773 P.2d 1143 (1989).

Cited Ogilvie v. Idaho Bank & Trust Co., 99 Idaho 361, 582 P.2d 215 (1978); Anderson & Nafziger v. G.T. Newcomb, Inc., 100 Idaho 175, 595 P.2d 709 (1979); Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983); Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

RESEARCH REFERENCES

Idaho Law Review. — Choice of Law in Idaho: A Survey and Critique of Idaho Cases, Andrew S. Jorgensen. 49 Idaho L. Rev. 547 (2013).

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 39 et seq.

67A Am. Jur. 2d, Sales, § 878 et seq.

68A Am. Jur. 2d, Secured Transactions, §§ 8, 9.

Official Comment

Source: Former Section 1-105.

Changes from former law: This section is substantively identical to former Section 1-105. Changes in language are stylistic only.

1. Subsection (a) states affirmatively the right of the parties to a multi-state transaction or a transaction involving foreign trade to choose their own law. That right is subject to the firm rules stated in the sections listed in subsection (c), and is limited to jurisdictions to which the transaction bears a "reasonable relation." In general, the test of "reasonable relation" is similar to that laid down by the Supreme Court in *Seeman v. Philadelphia Warehouse Co*., 274 U.S. 403, 47 S.Ct. 626, 71 L.Ed. 1123 (1927). Ordinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs. But an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen.

2. Where there is no agreement as to the governing law, the Act is applicable to any transaction having an "appropriate" relation to any state which enacts it. Of course, the Act applies to any transaction which takes place in its entirety in a state which has enacted the Act. But the mere fact that suit is brought in a state does not make it appropriate to apply the substantive law of that state. Cases where a relation to the enacting state is not "appropriate" include, for example, those where the parties have clearly contracted on the basis of some other law, as where the law of the place of contracting and the law of the place of contemplated performance are the same and are contrary to the law under the Code.

3. Where a transaction has significant contacts with a state which has enacted the Act and also with other jurisdictions, the question what relation is "appropriate" is left to judicial decision. In deciding that question, the court is not strictly bound by precedents established in other contexts. Thus a conflict-of-laws decision refusing to apply a purely local statute or rule of law to a particular multi-state transaction may not be valid precedent for refusal to apply the Code in an analogous situation. Application of the Code in such circumstances may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that it is in large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries. Compare *Global Commerce Corp. v. Clark-Babbitt Industries, Inc.*, 239 F.2d 716, 719 (2d Cir. 1956). In particular, where a transaction is governed in large part by the Code, application of another law to some detail of performance because of an accident of geography may violate the commercial understanding of the parties.

4. Subsection (c) spells out essential limitations on the parties' right to choose the applicable law. Especially in Article 9 parties taking a security interest or asked to extend credit which may be subject to a security interest must have sure ways to find out whether and where to file and where to look for possible existing filings.

5. Sections 9-301 through 9-307 should be consulted as to the rules for perfection of security interests and agricultural liens and the effect of perfection and nonperfection and priority.

6. This section is subject to Section 1-102, which states the scope of Article 1. As that section indicates, the rules of Article 1, including this section, apply to a transaction to the extent that transaction is governed by one of the other Articles of the Uniform Commercial Code.

§ 28-1-302. Variation by agreement. — (a) Except as otherwise provided in subsection (b) of this section or elsewhere in the uniform commercial code, the effect of provisions of the uniform commercial code may be varied by agreement.

(b) The obligations of good faith, diligence, reasonableness, and care prescribed by the uniform commercial code may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever the uniform commercial code requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

(c) The presence in certain provisions of the uniform commercial code of the phrase "unless otherwise agreed," or words of similar import, does not imply that the effect of other provisions may not be varied by agreement under this section.

History.

I.C., § 28-1-302, as added by 2004, ch. 43, § 20, p. 136.

Official Comment

Source: Former Sections 1-102(3)-(4) and 1-204(1).

Changes: This section combines the rules from subsections (3) and (4) of former Section 1-102 and subsection (1) of former Section 1-204. No substantive changes are made.

1. Subsection (a) states affirmatively at the outset that freedom of contract is a principle of the Uniform Commercial Code: "the effect" of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the Uniform Commercial Code seeks to avoid the type of interference with evolutionary growth found in pre-Code cases such as *Manhattan Co. v. Morgan*, 242 N.Y. 38, 150 N.E. 594 (1926). Thus, private parties cannot make an

instrument negotiable within the meaning of Article 3 except as provided in Section 3-104; nor can they change the meaning of such terms as "bona fide purchaser," "holder in due course," or "due negotiation," as used in the Uniform Commercial Code. But an agreement can change the legal consequences that would otherwise flow from the provisions of the Uniform Commercial Code. "Agreement" here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1-201 and 1-303; the effect of an agreement on the rights of third parties is left to specific provisions of the Uniform Commercial Code and to supplementary principles applicable under Section 1-103. The rights of third parties under Section 9-317 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Uniform Commercial Code and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2-201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the "contract" made unenforceable; Section 9-602, on the other hand, is a quite explicit limitation on freedom of contract. Under the exception for "the obligations of good faith, diligence, reasonableness and care prescribed by [the Uniform Commercial Code]," provisions of the Uniform Commercial Code prescribing such obligations are not to be disclaimed. However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls. In this connection, Section 1-303 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

Subsection (b) also recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.

2. An agreement that varies the effect of provisions of the Uniform Commercial Code may do so by stating the rules that will govern in lieu of the provisions varied. Alternatively, the parties may vary the effect of such provisions by stating that their relationship will be governed by recognized bodies of rules or principles applicable to commercial transactions. Such bodies of rules or principles may include, for example, those that are promulgated by intergovernmental authorities such as UNCITRAL or Unidroit (*see, e.g.*, Unidroit Principles of International Commercial Contracts), or non-legal codes such as trade codes.

3. Subsection (c) is intended to make it clear that, as a matter of drafting, phrases such as "unless otherwise agreed" have been used to avoid controversy as to whether the subject matter of a particular section does or does not fall within the exceptions to subsection (b), but absence of such words contains no negative implication since under subsection (b) the general and residual rule is that the effect of all provisions of the Uniform Commercial Code may be varied by agreement.

§ 28-1-303. Course of performance, course of dealing, and usage of trade. — (a) A "course of performance" is a sequence of conduct between the parties to a particular transaction that exists if:

(1) The agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and

(2) The other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

(b) A "course of dealing" is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(c) A "usage of trade" is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

(d) A course of performance or course of dealing between the parties or usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement. A usage of trade applicable in the place in which part of the performance under the agreement is to occur may be so utilized as to that part of the performance.

(e) Except as otherwise provided in subsection (f) of this section, the express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade shall be construed wherever reasonable as consistent with each other. If such a construction is unreasonable:

(1) Express terms prevail over course of performance, course of dealing, and usage of trade;

(2) Course of performance prevails over course of dealing and usage of trade; and

(3) Course of dealing prevails over usage of trade.

(f) Subject to section 28-2-209, Idaho Code, a course of performance is relevant to show a waiver or modification of any term inconsistent with the course of performance.

(g) Evidence of a relevant usage of trade offered by one (1) party is not admissible unless that party has given the other party notice that the court finds sufficient to prevent unfair surprise to the other party.

History.

1967, ch. 161, § 1-205, p. 351; am. and redesig. 2004, ch. 43, § 21, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-205.

CASE NOTES

Agreement limiting remedies.

Course of dealing.

Usage of trade.

Agreement Limiting Remedies.

In the situation where farmer bought certified potato seed from dealer and seed was later found to be infected by bacterial ring rot, because factual questions remained as to whether there were any terms in the parties' agreement excluding warranties or limiting remedies and as to whether there was an applicable course of dealing or trade usage limiting remedies, the lower court's order denying summary judgment on this issue was affirmed. Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995).

Course of Dealing.

In determining how a maturity clause in a loan agreement should be interpreted, the trial court was correct in refusing to consider course of dealing, where the lender's conduct, asserted by the borrower, was "subsequent conduct" rather than "previous conduct." Idaho First Nat'l Bank v. David Steed & Assocs., 121 Idaho 356, 825 P.2d 79 (1992).

Seller effectively disclaimed all implied warranties where a course of dealing was established by over 160 mail invoices over four years each containing a disclaimer, and where tanks containing the purchased pesticide always carried a valid warranty disclaimer on the side. Tolmie Farms, Inc. v. J.R. Simplot Co., 124 Idaho 607, 862 P.2d 299 (1993).

Usage of Trade.

Grant of summary judgment in favor of lessor in his action seeking to recover unpaid rent for the rental of a Bobcat was appropriate because the term "working day" in the lease agreement was unambiguous. Swanson v. BECO Constr. Co., 145 Idaho 59, 175 P.3d 748 (2007).

Where, based upon the clear language of the contract and usage of trade, a buyer had the right to designate the fields from which an order of onions came, and the seller attempted to deliver onions that were not from the designated fields, the buyer rightfully rejected the non-conforming goods under § 28-2-601(a). Panike & Sons Farms, Inc. v. Smith, 147 Idaho 562, 212 P.3d 992 (2009).

Cited Harvey v. Fearless Farris Whsle., Inc., 589 F.2d 451 (9th Cir. 1979); Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983); Idaho Bank & Trust Co. v. Cargill, Inc., 105 Idaho 83, 665 P.2d 1093 (Ct. App. 1983); Airstream, Inc. v. CIT Fin. Servs., Inc., 111 Idaho 307, 723 P.2d 851 (1986); Fox v. Mt. W. Elec., Inc., 137 Idaho 703, 52 P.3d 848 (2002).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 26 et seq.

17A Am. Jur. 2d, Contracts, § 361

67 Am. Jur. 2d, Sales, § 20 et seq.

Official Comment

Source: Former Sections 1-205, 2-208, and Section 2A-207.

Changes from former law: This section integrates the "course of performance" concept from Articles 2 and 2A into the principles of former Section 1-205, which deals with course of dealing and usage of trade. In so doing, the section slightly modifies the articulation of the course of performance rules to fit more comfortably with the approach and structure of former Section 1-205. There are also slight modifications to be more consistent with the definition of "agreement" in former Section 1-201(3). It should be noted that a course of performance that might otherwise establish a defense to the obligation of a party to a negotiable instrument is not available as a defense against a holder in due course who took the instrument without notice of that course of performance.

1. The Uniform Commercial Code rejects both the "lay-dictionary" and the "conveyancer's" reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

2. "Course of dealing," as defined in subsection (b), is restricted, literally, to a sequence of conduct between the parties previous to the agreement. A sequence of conduct after or under the agreement, however, is a "course of performance." "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.

3. The Uniform Commercial Code deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement that the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade," the Uniform Commercial Code expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law." A distinction is to be drawn between mandatory rules of law such as the

Statute of Frauds provisions of Article 2 on Sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on Sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

4. A usage of trade under subsection (c) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial," "universal," or the like. Under the requirement of subsection (c) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.

5. The policies of the Uniform Commercial Code controlling explicit unconscionable contracts and clauses (Sections 1-304, 2-302) apply to implicit clauses that rest on usage of trade and carry forward the policy underlying the ancient requirement that a custom or usage must be "reasonable." However, the emphasis is shifted. The very fact of commercial acceptance makes out a *prima facie* case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.

6. Subsection (d), giving the prescribed effect to usages of which the parties "are or should be aware," reinforces the provision of subsection (c) requiring not universality but only the described "regularity of observance" of the practice or method. This subsection also reinforces the point of subsection (c) that such usages may be either general to trade or particular to a special branch of trade.

7. Although the definition of "agreement" in Section 1-201 includes the elements of course of performance, course of dealing, and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare Section 1-302(c).

8. In cases of a well established line of usage varying from the general rules of the Uniform Commercial Code where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.

9. Subsection (g) is intended to insure that this Act's liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.

§ 28-1-304. Obligation of good faith. — Every contract or duty within the uniform commercial code imposes an obligation of good faith in its performance and enforcement.

History.

1967, ch. 161, § 1-203, p. 351; am. and redesig. 2004, ch. 43, § 22, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-203.

CASE NOTES

Absence of Knowledge.

An examination of the priority and foreclosure scheme of Article 9 demonstrates that absence of knowledge of subordinate security interests could not be a prerequisite for a purchaser to buy property free of encumbrances at a foreclosure sale; for, if absence of knowledge were required, the party whose interest would be undermined would be the secured party who was conducting the sale. Northwest Equip. Sales Co. v. Western Packers, Inc., 623 F.2d 92 (9th Cir. 1980).

Allegations of Bad Faith.

A party's allegations of bad faith must relate exclusively to the failure to perform the obligations of the contract, not to misrepresentations occurring during the negotiations preceding the contract. Potlatch Corp. v. Beloit Corp., 132 Idaho 712, 979 P.2d 114 (1999).

Duty of Good Faith.

The plaintiff purchasers had a duty to act in good faith to provide the defendant sellers with a reasonable opportunity to repair or replace any defective parts. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

The duty of this section does not demand that defendant exhaust all possible means of collection, or that he pursue the most effective means of enforcing payment; but, rather, it requires him to make reasonable efforts to secure payment. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Purchase at Foreclosure Sale.

Although the seller of various items of fruit packing machinery had retained a security interest to secure the purchase price, a subsequent foreclosure sale of the real property to which the machinery was affixed discharged the security interest held by the seller of the machinery, where the purchase at the foreclosure sale of the real estate and fruit packing machinery was in good faith. Northwest Equip. Sales Co. v. Western Packers, Inc., 623 F.2d 92 (9th Cir. 1980).

Cited Scott v. Castle, 104 Idaho 719, 662 P.2d 1163 (Ct. App. 1983); Badell v. Badell, 122 Idaho 442, 835 P.2d 677 (Ct. App. 1992).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 252 et seq.

15A Am. Jur. 2d, Commercial Code, § 19.

17A Am. Jur. 2d, Contracts, § 370.

67 Am. Jur. 2d, Sales, § 334.

ALR. — Cross-examination of character witness for accused with reference to particular acts or crimes — Modern state rules. 13 A.L.R.4th 796.

Official Comment

Source: Former Section 1-203.

Changes from former law: Except for changing the form of reference to the Uniform Commercial Code, this section is identical to former Section 1-203.

1. This section sets forth a basic principle running throughout the Uniform Commercial Code. The principle is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. While this duty is explicitly stated in some provisions of the Uniform Commercial Code, the applicability of the duty is broader than merely these situations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by Section 1-303 on course of dealing, course of performance, and usage of trade. This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached.

2. "Performance and enforcement" of contracts and duties within the Uniform Commercial Code include the exercise of rights created by the Uniform Commercial Code.

§ 28-1-305. Remedies to be liberally administered. — (a) The remedies provided by the uniform commercial code shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in the uniform commercial code or by other rule of law.

(b) Any right or obligation declared by the uniform commercial code is enforceable by action unless the provision declaring it specifies a different and limited effect.

History.

1967, ch. 161, § 1-106, p. 351; am. and redesig. 2004, ch. 43, § 23, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-106.

CASE NOTES

Lost Profit Damages.

District court had not erred in its findings regarding lost profit damages for the increased cost of raising fish during years four and five of the contract between a trout hatchery and a trout grower and for increased mortality losses during the same period because the hatchery failed to timely accept delivery of the trout according to the terms of the contract. Griffith v. Clear Lakes Trout Co., 143 Idaho 733, 152 P.3d 604 (2007).

Cited Panike & Sons Farms, Inc. v. Smith, 147 Idaho 562, 212 P.3d 992 (2009).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 577 et seq.

67A Am. Jur. 2d, Sales, § 795 et seq.

68A Am. Jur. 2d, Secured Transactions, § 514 et seq.

Official Comment

Source: Former Section 1-106.

Changes from former law: Other than changes in the form of reference to the Uniform Commercial Code, this section is identical to former Section 1-106.

1. Subsection (a) is intended to effect three propositions. The first is to negate the possibility of unduly narrow or technical interpretation of remedial provisions by providing that the remedies in the Uniform Commercial Code are to be liberally administered to the end stated in this section. The second is to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Uniform Commercial Code elsewhere makes it clear that damages must be minimized. Cf. Sections 1-304, 2-706(1), and 2-712(2). The third purpose of subsection (a) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2-204(3).

2. Under subsection (b), any right or obligation described in the Uniform Commercial Code is enforceable by action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1-103, 2-716.

3. “Consequential” or “special” damages and “penal” damages are not defined in the Uniform Commercial Code; rather, these terms are used in the sense in which they are used outside the Uniform Commercial Code.

§ 28-1-306. Waiver or renunciation of claim or right after breach. — A claim or right arising out of an alleged breach may be discharged in whole or in part without consideration by agreement of the aggrieved party in an authenticated record.

History.

1967, ch. 161, § 1-107, p. 351; am. and redesig. 2004, ch. 43, § 24, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-107.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 170.

67A Am. Jur. 2d, Sales, § 878 et seq.

68A Am. Jur. 2d, Secured Transactions, § 683 et seq.

Official Comment

Source: Former Section 1-107.

Changes from former law: This section changes former law in two respects. First, former Section 1-107, requiring the "delivery" of a "written waiver or renunciation" merges the separate concepts of the aggrieved party's agreement to forgo rights and the manifestation of that agreement. This section separates those concepts, and explicitly requires *agreement* of the aggrieved party. Second, the revised section reflects developments in electronic commerce by providing for memorialization in an authenticated record. In this context, a party may "authenticate" a record by (i) signing a record that is a writing or (ii) attaching to, or logically associating with a record that is not a writing, an electronic sound, symbol or process with the

present intent to adopt or accept the record. See Sections 1-201(b)(37) and 9-102(a)(7).

1. This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where the agreement effecting such renunciation is memorialized in a record authenticated by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith. (Section 1-304).

§ 28-1-307. Prima facie evidence by third party documents. — A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher's or inspector's certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party is prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

History.

1967, ch. 161, § 1-202, p. 351; am. and redesig. 2004, ch. 43, § 25, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-202.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 31.

Official Comment

Source: Former Section 1-202.

Changes from former law: Except for minor stylistic changes, this Section is identical to former Section 1-202.

1. This section supplies judicial recognition for documents that are relied upon as trustworthy by commercial parties.

2. This section is concerned only with documents that have been given a preferred status by the parties themselves who have required their procurement in the agreement, and for this reason the applicability of the section is limited to actions arising out of the contract that authorized or required the document. The list of documents is intended to be illustrative and not exclusive.

3. The provisions of this section go no further than establishing the documents in question as prima facie evidence and leave to the court the ultimate determination of the facts where the accuracy or authenticity of the documents is questioned. In this connection the section calls for a commercially reasonable interpretation.

4. Documents governed by this section need not be writings if records in another medium are generally relied upon in the context.

§ 28-1-308. Performance or acceptance under reservation of rights. —

(a) A party that with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice," "under protest," or the like are sufficient.

(b) Subsection (a) of this section does not apply to an accord and satisfaction.

History.

1967, ch. 161, § 1-207, p. 351; am. 1993, ch. 288, § 49, p. 1019; am. and redesig. 2004, ch. 43, § 26, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly compiled as § 28-1-207.

CASE NOTES

Cited Perkins v. Highland Enters., Inc., 120 Idaho 511, 817 P.2d 177 (1991).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 32.

17A Am. Jur. 2d, Contracts, §§ 635, 636.

Official Comment

Source: Former Section 1-207.

Changes from former law: This section is identical to former Section 1-207.

1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment "without prejudice," "under protest," "under reserve," "with reservation of all our rights," and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made "subject to satisfaction of our purchaser," "subject to acceptance by our customers," or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as that party makes or concurs in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer's remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other believes to be unwarranted.

3. Subsection (b) states that this section does not apply to an accord and satisfaction. Section 3-311 governs if an accord and satisfaction is attempted by tender of a negotiable instrument as stated in that section. If Section 3-311 does not apply, the issue of whether an accord and satisfaction has been effected is determined by the law of contract. Whether or not Section 3-311 applies, this section has no application to an accord and satisfaction.

§ 28-1-309. Option to accelerate at will. — A term providing that one (1) party or that party's successor in interest may accelerate payment or performance or require collateral or additional collateral "at will" or when the party "deems itself insecure," or words of similar import, means that the party has power to do so only if that party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against which the power has been exercised.

History.

1967, ch. 161, § 1-208, p. 351; am. and redesig. 2004, ch. 43, § 27, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section was formerly codified as § 28-1-208.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, §§ 92, 93.

15A Am. Jur. 2d, Commercial Code, § 33.

Official Comment

Source: Former Section 1-208.

Changes from former law: Except for minor stylistic changes, this section is identical to former Section 1-208.

1. The common use of acceleration clauses in many transactions governed by the Uniform Commercial Code, including sales of goods on credit, notes payable at a definite time, and secured transactions, raises an issue as to the effect to be given to a clause that seemingly grants the power to accelerate at the whim and caprice of one party. This section is intended to make clear that despite language that might be so construed and which

further might be held to make the agreement void as against public policy or to make the contract illusory or too indefinite for enforcement, the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired.

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an obligation of payment or performance which in the first instance is due at a future date.

§ 28-1-310. Subordinated obligations. — An obligation may be issued as subordinated to performance of another obligation of the person obligated, or a creditor may subordinate its right to performance of an obligation by agreement with either the person obligated or another creditor of the person obligated. Subordination does not create a security interest as against either the common debtor or a subordinated creditor.

History.

I.C., § 28-1-310, as added by 2004, ch. 43, § 28, p. 136.

Official Comment

Source: Former Section 1-209.

Changes from former law: This section is substantively identical to former Section 1-209. The language in that section stating that it "shall be construed as declaring the law as it existed prior to the enactment of this section and not as modifying it" has been deleted.

1. Billions of dollars of subordinated debt are held by the public and by institutional investors. Commonly, the subordinated debt is subordinated on issue or acquisition and is evidenced by an investment security or by a negotiable or nonnegotiable note. Debt is also sometimes subordinated after it arises, either by agreement between the subordinating creditor and the debtor, by agreement between two creditors of the same debtor, or by agreement of all three parties. The subordinated creditor may be a stockholder or other "insider" interested in the common debtor; the subordinated debt may consist of accounts or other rights to payment not evidenced by any instrument. All such cases are included in the terms "subordinated obligation," "subordination," and "subordinated creditor."

2. Subordination agreements are enforceable between the parties as contracts; and in the bankruptcy of the common debtor dividends otherwise payable to the subordinated creditor are turned over to the superior creditor. This "turn-over" practice has on occasion been explained in terms of "equitable lien," "equitable assignment," or "constructive trust," but

whatever the label the practice is essentially an equitable remedy and does not mean that there is a transaction "that creates a security interest in personal property . . . by contract" or a "sale of accounts, chattel paper, payment intangibles, or promissory notes" within the meaning of Section 9-109. On the other hand, nothing in this section prevents one creditor from assigning his rights to another creditor of the same debtor in such a way as to create a security interest within Article 9, where the parties so intend.

3. The enforcement of subordination agreements is largely left to supplementary principles under Section 1-103. If the subordinated debt is evidenced by a certificated security, Section 8-202(a) authorizes enforcement against purchasers on terms stated or referred to on the security certificate. If the fact of subordination is noted on a negotiable instrument, a holder under Sections 3-302 and 3-306 is subject to the term because notice precludes him from taking free of the subordination. Sections 3-302(3)(a), 3-306, and 8-317 severely limit the rights of levying creditors of a subordinated creditor in such cases.

Chapter 2
UNIFORM COMMERCIAL CODE — SALES

Part 1. Short Title, General Construction and Subject Matter

Sec.

Part 2. Form, Formation and Readjustment of Contract

Part 3. General Obligation and Construction of Contract

Part 6. Breach, Repudiation and Excuse

Part 7. Remedies

Part 1
Short Title, General Construction and Subject Matter

§ 28-2-101. Short title. — This chapter shall be known and may be cited as Uniform Commercial Code — Sales.

History.

1967, ch. 161, § 2-101, p. 351.

STATUTORY NOTES

Compiler's Notes.

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CASE NOTES

Scope.

Where contract involved delivery of potatoes, the potatoes were movable at the time they were identified in the contract and, thus, were "goods" under § 28-2-105, so that the transaction was governed by the Uniform Commercial Code. G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

Sale of a used vehicle falls under Idaho's version of the Uniform Commercial Code governing sales. Haight v. Dale's Used Cars, Inc., 139 Idaho 853, 87 P.3d 962 (Ct. App. 2003).

Cited Smith v. Great Basin Grain Co., 98 Idaho 266, 561 P.2d 1299 (1977); Clark v. Enneking, 108 Idaho 691, 701 P.2d 311 (Ct. App. 1985); Old W. Realty, Inc. v. Idaho State Tax Comm'n, 110 Idaho 546, 716 P.2d 1318 (1986).

RESEARCH REFERENCES

ALR. — Conclusiveness of determination of third party whose approval is provided for by contract for sale of goods. 7 A.L.R.3d 555.

“Out of pocket” or “benefit of bargain” as proper rule of damages for fraudulent representations inducing contract for the transfer of property. 13 A.L.R.3d 875.

Authorization, prohibition, or regulation by municipality of the sale of merchandise on streets or highways, or their use for such purpose. 14 A.L.R.3d 896.

Enforceability of transaction entered into pursuant to referral sales arrangement. 14 A.L.R.3d 1420.

Construction and effect of UCC Art. 2, dealing with sales. 17 A.L.R.3d 1010.

“Unconscionability” as ground for refusing enforcement of contract for sale of goods or agreement collateral thereto. 18 A.L.R.3d 1305.

Electricity, gas, or water furnished by public utility as “goods” within provisions of Uniform Commercial Code, Article 2 on Sales. 48 A.L.R.3d 1060.

Consumer class actions based on fraud or misrepresentation. 53 A.L.R.3d 534.

Risk of loss of goods in “sale or return” transaction under UCC § 2-327. 66 A.L.R.3d 190.

What amounts to “sale” of property for purposes of provision giving tenant right of first refusal if landlord desires to sell. 70 A.L.R.3d 203.

Construction and effect of UCC § 2-316(2) providing that implied warranty disclaimer must be “conspicuous.” 73 A.L.R.3d 248.

Construction and application of UCC § 2-201(3)(b) rendering contract of sale enforceable notwithstanding statute of frauds, to extent it is admitted in pleading, testimony, or otherwise in court. 88 A.L.R.3d 416.

Seller’s recovery of price of goods from buyer under UCC § 2-709. 90 A.L.R.3d 1141.

Construction and application of UCC § 2-305 dealing with open price term contracts. 91 A.L.R.3d 1237.

Impracticability of performance of sales contract as defense under UCC § 2-615. 93 A.L.R.3d 584.

Farmers as “merchants” within provisions of UCC Article 2, dealing with sales. 95 A.L.R.3d 484.

Conflict of laws as to validity and effect of arbitration provision in contract for purchase or sale of goods, products, or services. 95 A.L.R.3d 1145.

Buyer’s incidental and consequential damages from seller’s breach under UCC § 2-715. 96 A.L.R.3d 299.

Requirements contracts under § 2-306(1) of Uniform Commercial Code. 96 A.L.R.3d 1275.

Construction and application of UCC § 2-201(3)(c) rendering contract of sale enforceable notwithstanding statute of frauds with respect to goods for which payment has been made and accepted or which have been received and accepted. 97 A.L.R.3d 98.

Contractual liquidated damages provisions under UCC article 2. 98 A.L.R.3d 586.

What constitutes “substantial impairment” entitling buyer to revoke his acceptance of goods under UCC § 2-608(1). 38 A.L.R.5th 191.

What constitutes a transaction, a contract for sale, or a sale within the scope of UCC article 2. 4 A.L.R.4th 85.

What constitutes “goods” within the scope of UCC Article 2. 4 A.L.R.4th 912.

Specific performance of sale of goods under UCC § 2-716. 26 A.L.R.4th 294.

Output contracts under § 2-306(1) of Uniform Commercial Code. 30 A.L.R.4th 396.

Seller’s cure of improper tender or delivery under UCC § 2-508. 36 A.L.R.4th 110.

Sales: “special manufactured goods” statute of frauds exception in UCC § 2-201(3)(a). 45 A.L.R.4th 1126.

Official Comment This Article [Chapter] is a complete revision and modernization of the Uniform Sales Act which was promulgated by the National Conference of Commissioners on Uniform State Laws in 1906 and has been adopted in 34 states and Alaska, the District of Columbia and Hawaii.

The coverage of the present Article [Chapter] is much more extensive than that of the old Sales Act and extends to the various bodies of case law which have been developed both outside of and under the latter.

The arrangement of the present Article [Chapter] is in terms of contract for sale and the various steps of its performance. The legal consequences are stated as following directly from the contract and action taken under it without resorting to the idea of when property or title passed or was to pass as being the determining factor. The purpose is to avoid making practical issues between practical men turn upon the location of an intangible something, the passing of which no man can prove by evidence and to substitute for such abstractions proof of words and actions of a tangible character.

§ 28-2-102. Scope — Certain security and other transactions excluded from this chapter. — Unless the context otherwise requires, this chapter applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this chapter impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers.

History.

1967, ch. 161, § 2-102, p. 351.

CASE NOTES

Scope.

A contract for the sale of steel pipe involved a sale of goods and was within the scope of the uniform commercial code. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

The UCC applies only to contracts for the sale of goods and does not apply to a contract for services. Steiner Corp. v. American Dist. Tel., 106 Idaho 787, 683 P.2d 435 (1984).

Where the predominant factor, thrust, and purpose of the city's contract for supplying and installing of the secondary treatment equipment of the city's sewage treatment plant was for the sale of goods, with a necessary, non-divisible, but incidental, services component, the contract was governed by the Uniform Commercial Code. United States v. City of Twin Falls, 806 F.2d 862 (9th Cir. 1986), cert. denied, 482 U.S. 914, 107 S. Ct. 3185, 96 L. Ed. 2d 674 (1987).

Section 28-2-725, and not § 5-216, controls all actions for breach of contract for the sale of goods, for this section provides that, unless the context otherwise requires, this chapter applies to transactions in goods.

Farmers Nat'l Bank v. Wickham Pipeline Constr., 114 Idaho 565, 759 P.2d 71 (1988).

In a case concerning a hybrid transaction involving both a sale of goods implicating the UCC and a sale of services not implicating the UCC, with the predominant purpose being for the provision of services, since the issue presented could have been resolved by an explicit provision in the agreement, the parties' choice of California law was given effect. Ward v. Puregro Co., 128 Idaho 366, 913 P.2d 582 (1996).

Where a company that provided services in designing and testing fire alarm systems sued a firm that installed electrical wiring and conduit for money owed for materials and services, and there was an implied-in-fact contract, the trial court did not err by finding that the predominant factor of the underlying transaction was services and that the Uniform Commercial Code did not apply. Fox v. Mt. W. Elec., Inc., 137 Idaho 703, 52 P.3d 848 (2002).

Cited Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991); Magic Valley Foods, Inc. v. Sun Valley Potatoes, Inc., 134 Idaho 785, 10 P.3d 734 (2000).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 1 et seq.

Official Comment

Prior Uniform Statutory Provision: Section 75, Uniform Sales Act.

Changes: Section 75 has been rephrased.

Purposes of Changes and New Matter: To make it clear that: The Article [Chapter] leaves substantially unaffected the law relating to purchase money security such as conditional sale or chattel mortgage though it regulates the general sales aspects of such transactions. "Security transaction" is used in the same sense as in the Article [Chapter] on Secured Transactions (Article [Chapter] 9).

Cross Reference: Article [Chapter] 9.

Definitional Cross References: "Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Present sale." Section 2-106.

"Sale." Section 2-106.

§ 28-2-103. Definitions and index of definitions. — (1) In this chapter unless the context otherwise requires:

(a) "Buyer" means a person who buys or contracts to buy goods.

(b) "Good faith" in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.

(c) "Receipt" of goods means taking physical possession of them.

(d) "Seller" means a person who sells or contracts to sell goods.

(2) Other definitions applying to this chapter or to specified parts thereof, and the sections in which they appear are: "Acceptance." Section 28-2-606[, Idaho Code].

"Banker's credit." Section 28-2-325[, Idaho Code].

"Between merchants." Section 28-2-104[, Idaho Code].

"Cancellation." Section 28-2-106[, Idaho Code].

"Commercial unit." Section 28-2-105[, Idaho Code].

"Confirmed credit." Section 28-2-325[, Idaho Code].

"Conforming to contract." Section 28-2-106[, Idaho Code].

"Contract for sale." Section 28-2-106[, Idaho Code].

"Cover." Section 28-2-712[, Idaho Code].

"Entrusting." Section 28-2-403[, Idaho Code].

"Financing agency." Section 28-2-104[, Idaho Code].

"Future goods." Section 28-2-105[, Idaho Code].

"Goods." Section 28-2-105[, Idaho Code].

"Identification." Section 28-2-501[, Idaho Code].

"Installment contract." Section 28-2-612[, Idaho Code].

"Letter of credit." Section 28-2-325[, Idaho Code].

“Lot.” Section 28-2-105[, Idaho Code].

“Merchant.” Section 28-2-104[, Idaho Code].

“Overseas.” Section 28-2-323[, Idaho Code].

“Person in position of seller.” Section 28-2-707[, Idaho Code].

“Present sale.” Section 28-2-106[, Idaho Code].

“Sale.” Section 28-2-106[, Idaho Code].

“Sale on approval.” Section 28-2-326[, Idaho Code].

“Sale or return.” Section 28-2-326[, Idaho Code].

“Termination.” Section 28-2-106[, Idaho Code].

(3) “Control” as provided in section 28-7-106[, Idaho Code,] and the following definitions in other chapters apply to this chapter: “Check.” Section 28-3-104[, Idaho Code].

“Consignee.” Section 28-7-102[, Idaho Code].

“Consignor.” Section 28-7-102[, Idaho Code].

“Consumer goods.” Section 28-9-102[, Idaho Code].

“Dishonor.” Section 28-3-502[, Idaho Code].

“Draft.” Section 28-3-104[, Idaho Code].

(4) In addition, chapter 1, title 28, Idaho Code, contains general definitions and principles of construction and interpretation applicable throughout this chapter.

History.

1967, ch. 161, § 2-103, p. 351; am. 2001, ch. 208, § 5, p. 704; am. 2004, ch. 42, § 4, p. 77.

STATUTORY NOTES

Compiler’s Notes.

The bracketed insertions throughout subsections (2) and (3) were added by the compiler to conform to the statutory citation style.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

CASE NOTES

Good faith.

Receipt.

Sellers.

Good Faith.

Nothing in the Idaho Code's definitions of good faith, § 28-1-201 and subsection (1)(b) of this section, imposes an implicit requirement for a seller to match the lowest price available, nor do plaintiffs contend that defendant expressly undertook to offer such prices. Harvey v. Fearless Farris Whsle., Inc., 589 F.2d 451 (9th Cir. 1979).

Receipt.

Receipt and acceptance of goods is deemed to constitute an unambiguous overt admission by both parties that a contract actually exists and makes admissible oral evidence of other terms of the contract. Under the "receipt and acceptance" exception to the statute, a modified contract may be enforced to the extent of the goods that have been accepted. Thus, whether an implied agreement between building contractor and building supplies company regarding conditions of payment is viewed as modifying the terms of the parties' initial contract, or as an agreement to terminate the initial contract and create a new, "original" contract, its enforcement is not barred by the statute of frauds. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Sellers.

Whether suppliers of wheat were "merchants" under § 28-2-104(1) was only relevant to the breach of implied warranties of merchantability under § 28-2-314. Where the jury specifically found that suppliers not only breached an implied warranty of merchantability, but also found that an express warranty had been given that the wheat was spring wheat and that

such express warranty had been breached, the suppliers were "sellers" within the purview of subdivision (1)(d) of this section. Hence, the breach of the express warranty provided a sufficient basis for the award of consequential damages. Nezperce Storage Co. v. Zenner, 105 Idaho 464, 670 P.2d 871 (1983); Cottonwood Elevator Co. v. Zenner, 105 Idaho 469, 670 P.2d 876 (1983).

Cited Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983); Potlatch Corp. v. Beloit Corp., 132 Idaho 712, 979 P.2d 114 (1999).

Decisions Under Prior Law

Good faith and value.

Goods.

Good Faith and Value.

Mortgagee of personal property under mortgage securing antecedent debt was held as encumbrancer both in good faith and for value holding a lien superior to claim of purchaser of such property who had not removed it from seller's premises. Millick v. Stevens, 44 Idaho 347, 257 P. 30 (1927).

Goods.

Agreement to pay full face value of note upon demand was not contract for sale of "goods" under Uniform Sales Law. Wallace Bank & Trust Co. v. First Nat'l Bank, 40 Idaho 712, 237 P. 284 (1925).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 35.

67 Am. Jur. 2d, Sales, § 5 et seq.

68A Am. Jur. 2d, Secured Transactions, § 30 et seq.

Official Comment

Prior Uniform Statutory Provision: Subsection (1): Section 76, Uniform Sales Act.

Changes: The definitions of "buyer" and "seller" have been slightly rephrased, the reference in Section 76 of the prior Act to "any legal

successor in interest of such person" being omitted. The definition of "receipt" is new.

Purposes of Changes and New Matter: 1. The phrase "any legal successor in interest of such person" has been eliminated since Section 2-210 of this Article [Chapter], which limits some types of delegation of performance on assignment of a sales contract, makes it clear that not every such successor can be safely included in the definition. In every ordinary case, however, such successors are as of course included.

2. "Receipt" must be distinguished from delivery particularly in regard to the problems arising out of shipment of goods, whether or not the contract calls for making delivery by way of documents of title, since the seller may frequently fulfill his obligations to "deliver" even though the buyer may never "receive" the goods. Delivery with respect to documents of title is defined in Article [Chapter] 1 and requires transfer of physical delivery of a tangible document of title and transfer of control of an electronic document of title. Otherwise the many divergent incidents of delivery are handled incident by incident.

Cross References: Point 1: See Section 2-210 and Comment thereon.

Point 2: Section 1-201.

Definitional Cross Reference: "Person." Section 1-201.

§ 28-2-104. Definitions — "Merchant" — "Between merchants" — "Financing agency." — (1) "Merchant" means a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

(2) "Financing agency" means a bank, finance company or other person who in the ordinary course of business makes advances against goods or documents of title or who by arrangement with either the seller or the buyer intervenes in ordinary course to make or collect payment due or claimed under the contract for sale, as by purchasing or paying the seller's draft or making advances against it or by merely taking it for collection whether or not documents of title accompany or are associated with the draft. "Financing agency" includes also a bank or other person who similarly intervenes between persons who are in the position of seller and buyer in respect to the goods (section 28-2-707[, Idaho Code]).

(3) "Between merchants" means in any transaction with respect to which both parties are chargeable with the knowledge or skill of merchants.

History.

1967, ch. 161, § 2-104, p. 351; am. 2004, ch. 42, § 5, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion at the end of subsection (2) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Merchant.

Where lessor of car washing equipment did not manufacture or sell any equipment but only financed the purchase of equipment specifically selected by the lessee, the finance lessor was not a merchant and, thus no implied warranty of merchantability existed in the lease transaction. All-States Leasing Co. v. Bass, 96 Idaho 873, 538 P.2d 1177 (1975).

Whether suppliers of wheat were "merchants" under subsection (1) of this section was only relevant to the breach of implied warranties of merchantability under § 28-2-314. Where the jury specifically found that suppliers not only breached an implied warranty of merchantability, but also found that an express warranty had been given that the wheat was spring wheat and that such express warranty had been breached, the suppliers were "sellers" within the purview of § 28-2-103(1)(d) and, hence, the breach of the express warranty provided a sufficient basis for the award of consequential damages. Nezperce Storage Co. v. Zenner, 105 Idaho 464, 670 P.2d 871 (1983); Cottonwood Elevator Co. v. Zenner, 105 Idaho 469, 670 P.2d 876 (1983).

A crane rental corporation which, in the course of its business, performed substantial maintenance work on the cranes was a merchant under § 28-2-314. Essex Crane Rental Corp. v. Weyher/Livsey Constructors, Inc., 713 F. Supp. 1350 (D. Idaho 1989), rev'd on other grounds, 940 F.2d 1253 (9th Cir. 1991).

The district court correctly applied the definition of "merchant" in this section to the transaction between irrigation equipment contractor and lessor and lessee of farm, since all the parties were merchants with respect to the contract, and they all had "knowledge or skill peculiar to the practices or goods involved in the transaction". Tri-Circle, Inc. v. Brugger Corp., 121 Idaho 950, 829 P.2d 540 (Ct. App. 1992).

Cited Duff v. Bonner Bldg. Supply, Inc., 103 Idaho 432, 649 P.2d 391 (Ct. App. 1982); D.R. Curtis Co. v. Mason, 103 Idaho 476, 649 P.2d 1232 (Ct. App. 1982); Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983); Fernandez v. Western R.R. Bldrs., 112 Idaho 907, 736 P.2d 1361 (Ct. App. 1987); Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995); Potlatch Corp. v. Beloit Corp., 132 Idaho 712, 979 P.2d 114 (1999).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 5 et seq.

Official Comment

Prior Uniform Statutory Provision: None. But see Sections 15 (2), (5), 16(c), 45(2) and 71, Uniform Sales Act, and Sections 35 and 37, Uniform Bills of Lading Act for examples of the policy expressly provided for in this Article [Chapter].

Purposes: 1. This Article [Chapter] assumes that transactions between professionals in a given field require special and clear rules which may not apply to a casual or inexperienced seller or buyer. It thus adopts a policy of expressly stating rules applicable "between merchants" and "as against a merchant" wherever they are needed instead of making them depend upon the circumstances of each case as in the statutes cited above. This section lays the foundation of this policy by defining those who are to be regarded as professionals or "merchants" and by stating when a transaction is deemed to be "between merchants."

2. The term "merchant" as defined here roots in the "law merchant" concept of a professional in business. The professional status under the definition may be based upon specialized knowledge as to the goods, specialized knowledge as to business practices, or specialized knowledge as to both and which kind of specialized knowledge may be sufficient to establish the merchant status is indicated by the nature of the provisions.

The special provisions as to merchants appear only in this Article [Chapter] and they are of three kinds. Sections 2-201(2), 2-205, 2-207 and 2-209 dealing with the statute of frauds, firm offers, confirmatory memoranda and modification rest on normal business practices which are or ought to be typical of and familiar to any person in business. For purposes of these sections almost every person in business would, therefore, be deemed to be a "merchant" under the language "who . . . by his occupation holds himself out as having knowledge or skill peculiar to the practices. . . involved in the transaction . . ." since the practices involved in the transaction are non-specialized business practices such as answering mail. In this type of provision, banks or even universities, for example, well may

be "merchants." But even these sections only apply to a merchant in his mercantile capacity; a lawyer or bank president buying fishing tackle for his own use is not a merchant.

On the other hand, in Section 2-314 on the warranty of merchantability, such warranty is implied only "if the seller is a merchant with respect to goods of that kind." Obviously this qualification restricts the implied warranty to a much smaller group than everyone who is engaged in business and requires a professional status as to particular kinds of goods. The exception in Section 2-402(2) for retention of possession by a merchant-seller falls in the same class; as does Section 2-403(2) on entrusting of possession to a merchant "who deals in goods of that kind."

A third group of sections includes 2-103(1)(b), which provides that in the case of a merchant "good faith" includes observance of reasonable commercial standards of fair dealing in the trade; 2-327(1)(c), 2-603 and 2-605, dealing with responsibilities of merchant buyers to follow seller's instructions, etc.; 2-509 on risk of loss, and 2-609 on adequate assurance of performance. This group of sections applies to persons who are merchants under either the "practices" or the "goods" aspect of the definition of merchant.

3. The "or to whom such knowledge or skill may be attributed by his employment of an agent or broker . . ." clause of the definition of merchant means that even persons such as universities, for example, can come within the definition of merchant if they have regular purchasing departments or business personnel who are familiar with business practices and who are equipped to take any action required.

Cross References: Point 1: See Sections 1-102 and 1-203.

Point 2: See Sections 2-314, 2-315 and 2-320 to 2-325, of this Article [Chapter], and Article [Chapter] 9.

Definitional Cross References: "Bank." Section 1-201.

"Buyer." Section 2-103.

"Contract for sale." Section 2-106.

"Document of title." Section 1-201.

"Draft." Section 3-104.

"Goods." Section 2-105.

"Person." Section 1-201.

"Purchase." Section 1-201.

"Seller." Section 2-103.

§ 28-2-105. Definitions — Transferability — "Goods" — "Future" goods — "Lot" — "Commercial unit." — (1) "Goods" means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (chapter 8[, title 28, Idaho Code]) and things in action. "Goods" also includes the unborn young of animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty (section 28-2-107[, Idaho Code]).

(2) Goods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are "future" goods. A purported present sale of future goods or of any interest therein operates as a contract to sell.

(3) There may be a sale of a part interest in existing identified goods.

(4) An undivided share in an identified bulk of fungible goods is sufficiently identified to be sold although the quantity of the bulk is not determined. Any agreed proportion of such a bulk or any quantity thereof agreed upon by number, weight or other measure may to the extent of the seller's interest in the bulk be sold to the buyer who then becomes an owner in common.

(5) "Lot" means a parcel or a single article which is the subject matter of a separate sale or delivery, whether or not it is sufficient to perform the contract.

(6) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article (as a machine) or a set of articles (as a suite of furniture or an assortment of sizes) or a quantity (as a bale, gross, or carload) or any other unit treated in use or in the relevant market as a single whole.

History.

1967, ch. 161, § 2-105, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (1) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Goods.

Scope.

Goods.

Steel pipe constituted "goods" as defined by this section. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

Potatoes which were clearly movable at the time they were identified in a sales contract were "goods" within the purview of the Idaho Uniform Commercial Code. Borges v. Magic Valley Foods, Inc., 101 Idaho 494, 616 P.2d 273 (1980); G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

The sale of a log skidder was a sale of "goods" within the meaning of this section. Breeden v. Edmenson, 107 Idaho 319, 689 P.2d 211 (Ct. App. 1984).

Where the predominant factor, thrust, and purpose of the city's contract for supplying and installing of the secondary treatment equipment of the city's sewage treatment plant was for the sale of goods, with a necessary, non-divisible, but incidental, services component, the contract was governed by the UCC. United States v. City of Twin Falls, 806 F.2d 862 (9th Cir. 1986), cert. denied, 482 U.S. 914, 107 S. Ct. 3185, 96 L. Ed. 2d 674 (1987).

Scope.

In a case concerning a hybrid transaction involving both a sale of goods implicating the UCC and a sale of services not implicating the UCC, with the predominant purpose being for the provision of services, since the issue presented could have been resolved by an explicit provision in the agreement, the parties' choice of California law was given effect. Ward v. Puregro Co., 128 Idaho 366, 913 P.2d 582 (1996).

Cited Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983); Gebrueder Heidemann, K.G. v. A.M.R. Corp., 107 Idaho 275, 688 P.2d 1180 (1984); Howard v. Estate of Howard, 112 Idaho 306, 732 P.2d 275 (1987); NBC Leasing Co. v. R & T Farms, Inc., 114 Idaho 141, 754 P.2d 454 (Ct. App. 1988); Potlatch Corp. v. Beloit Corp., 132 Idaho 712, 979 P.2d 114 (1999); Jen-Rath Co. v. KIT Mfg. Co., 137 Idaho 330, 48 P.3d 659 (2002).

Decisions Under Prior Law

Goods.

Agreement to pay full face value of note upon demand was not contract for sale of "goods" under Uniform Sales Law. Wallace Bank & Trust Co. v. First Nat'l Bank, 40 Idaho 712, 237 P. 284 (1925).

Goods in Deliverable State.

Where purchaser contracted for "strictly number one merchantable hay," it could not be compelled to take delivery of hay other than that grade and until hay of that grade was segregated it was not in a deliverable state. Idaho Prods. Co. v. Bales, 36 Idaho 800, 214 P. 206 (1923).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 15 et seq.

68A Am. Jur. 2d, Secured Transactions, § 53 et seq.

ALR. — What constitutes "future goods" within scope of U.C.C. article 2. 48 A.L.R.6th 475.

Electricity, Gas, or Water Furnished by Public Utility or Alternative Supplier as "Goods" Within Provisions of Uniform Commercial Code, Article 2 on Sales. 97 A.L.R.6th 1.

Official Comment

Prior Uniform Statutory Provision: Subsections (1), (2), (3) and (4) — Sections 5, 6 and 76, Uniform Sales Act; Subsections (5) and (6) — none.

Changes: Rewritten.

Purposes of Changes and New Matter: 1. Subsection (1) on "goods": The phraseology of the prior uniform statutory provision has been changed so that: The definition of goods is based on the concept of movability and the term "chattels personal" is not used. It is not intended to deal with things which are not fairly identifiable as movables before the contract is performed.

Growing crops are included within the definition of goods since they are frequently intended for sale. The concept of "industrial" growing crops has been abandoned, for under modern practices fruit, perennial hay, nursery stock and the like must be brought within the scope of this Article [Chapter]. The young of animals are also included expressly in this definition since they, too, are frequently intended for sale and may be contracted for before birth. The period of gestation of domestic animals is such that the provisions of the section on identification can apply as in the case of crops to be planted. The reason of this definition also leads to the inclusion of a wool crop or the like as "goods" subject to identification under this Article [Chapter].

The exclusion of "money in which the price is to be paid" from the definition of goods does not mean that foreign currency which is included in the definition of money may not be the subject matter of a sales transaction. Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment.

As to contracts to sell timber, minerals, or structures to be removed from the land Section 2-107(1) (Goods to be severed from Realty: recording) controls.

The use of the word "fixtures" is avoided in view of the diversity of definitions of that term. This Article [Chapter] in including within its scope "things attached to realty" adds the further test that they must be capable of severance without material harm thereto. As between the parties any identified things which fall within that definition become "goods" upon the making of the contract for sale.

"Investment securities" are expressly excluded from the coverage of this Article [Chapter]. It is not intended by this exclusion, however, to prevent the application of a particular section of this Article [Chapter] by analogy to securities (as was done with the Original Sales Act in *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479, 99 A.L.R. 269 (1934)) when the reason of that section makes such application sensible and the situation involved is not covered by the Article [Chapter] of this Act dealing specifically with such securities (Article [Chapter] 8).

2. References to the fact that a contract for sale can extend to future or contingent goods and that ownership in common follows the sale of a part interest have been omitted here as obvious without need for expression; hence no inference to negate these principles should be drawn from their omission.

3. Subsection (4) does not touch the question of how far an appropriation of a bulk of fungible goods may or may not satisfy the contract for sale.

4. Subsections (5) and (6) on "lot" and "commercial unit" are introduced to aid in the phrasing of later sections.

5. The question of when an identification of goods takes place is determined by the provisions of Section 2-501 and all that this section says is what kinds of goods may be the subject of a sale.

Cross References: Point 1: Sections 2-107, 2-201, 2-501 and Article [Chapter] 8.

Point 5: Section 2-501.

See also Section 1-201.

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Fungible." Section 1-201.

"Money." Section 1-201.

"Present sale." Section 2-106.

"Sale." Section 2-106.

"Seller." Section 2-103.

§ 28-2-106. Definitions — "Contract" — "Agreement" — "Contract for sale" — "Sale" — "Present sale" — "Conforming" to contract — "Termination" — "Cancellation." — (1) In this chapter unless the context otherwise requires "contract" and "agreement" are limited to those relating to the present or future sale of goods. "Contract for sale" includes both a present sale of goods and a contract to sell goods at a future time. A "sale" consists in the passing of title from the seller to the buyer for a price (section 28-2-401[, Idaho Code]). A "present sale" means a sale which is accomplished by the making of the contract.

(2) Goods or conduct including any part of a performance are "conforming" or conform to the contract when they are in accordance with the obligations under the contract.

(3) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach. On "termination" all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives.

(4) "Cancellation" occurs when either party puts an end to the contract for breach by the other and its effect is the same as that of "termination" except that the cancelling party also retains any remedy for breach of the whole contract or any unperformed balance.

History.

1967, ch. 161, § 2-106, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in subsection (1) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Contract of sale.

Enforceability of contract.

Sale.

Contract of Sale.

Where agreement identified both parties, named the consideration, specified the model, make and serial number and was signed by both parties, this was sufficient for it to constitute a contract of sale even though it also allowed the seller, until buyer took possession, to sell to anyone else if he could get a higher price. Ace Supply, Inc. v. Rocky-Mountain Mach. Co., 96 Idaho 183, 525 P.2d 965 (1974).

Enforceability of Contract.

The Uniform Commercial Code provides that a contract not satisfying the statute of frauds is nonetheless enforceable if the party against who enforcement is sought admits in his testimony that a contract was made. Faw v. Greenwood, 101 Idaho 387, 613 P.2d 1338 (1980).

Sale.

The repurchase of parts, as provided by § 28-23-102, is a sale within the definition of subsection (1). MH & H Implement, Inc. v. Massey-Ferguson, Inc., 108 Idaho 879, 702 P.2d 917 (Ct. App. 1985).

Cited Harvey v. Fearless Farris Whsle., Inc., 589 F.2d 451 (9th Cir. 1979); Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Decisions Under Prior Law

Agreement to purchase note.

Cash sale.

Executed or executory contracts.

Offer and acceptance.

Agreement to Purchase Note.

Agreement to purchase certain note upon written demand, and to pay for such note its full face value and accruing interest, was not a sales contract,

but a promise to pay on demand the sum named. Wallace Bank & Trust Co. v. First Nat'l Bank, 40 Idaho 712, 237 P. 284 (1925).

Cash Sale.

A "cash sale" was one where payment and delivery were to be concurrent. Western Seed Marketing Co. v. Pfost, 45 Idaho 340, 262 P. 514 (1927).

Executed or Executory Contracts.

If the risk of loss from injury to, or destruction of, the property is on the buyer, the contract is executed, and, if on the seller, it is executory. Western Seed Marketing Co. v. Pfost, 45 Idaho 340, 262 P. 514 (1927); Peterson v. Universal Auto. Ins. Co., 53 Idaho 11, 20 P.2d 1016 (1933).

Offer and Acceptance.

Word "accepted" signed by buyer on offer in writing to sell definite quantity of certain article constituted valid contract of sale. O.A. Olin Co. v. Lambach, 35 Idaho 767, 209 P. 277 (1922).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, §§ 35, 69, 88.

67 Am. Jur. 2d, Sales, § 15 et seq.

68A Am. Jur. 2d, Secured Transactions, § 30 et seq.

Official Comment

Prior Uniform Statutory Provision: Subsection (1) — Section 1(1) and (2), Uniform Sales Act; Subsection (2) — none, but subsection generally continues policy of Sections 11, 44 and 69, Uniform Sales Act; Subsections (3) and (4) — none.

Changes: Completely rewritten.

Purposes of Changes and New Matter: 1. Subsection (1): "Contract for sale" is used as a general concept throughout this Article [Chapter], but the rights of the parties do not vary according to whether the transaction is a

present sale or a contract to sell unless the Article [Chapter] expressly so provides.

2. Subsection (2): It is in general intended to continue the policy of requiring exact performance by the seller of his obligations as a condition to his right to require acceptance. However, the seller is in part safeguarded against surprise as a result of sudden technicality on the buyer's part by the provisions of Section 2-508 on seller's cure of improper tender or delivery. Moreover usage of trade frequently permits commercial leeways in performance and the language of the agreement itself must be read in the light of such custom or usage and also, prior course of dealing, and in a long term contract, the course of performance.

3. Subsections (3) and (4): These subsections are intended to make clear the distinction carried forward throughout this Article [Chapter] between termination and cancellation.

Cross References: Point 2: Sections 1-203, 1-205 [1-303], 2-208 and 2-508.

Definitional Cross References: "Agreement." Section 1-201.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Party." Section 1-201.

"Remedy." Section 1-201.

"Rights." Section 1-201.

"Seller." Section 2-103.

§ 28-2-107. Goods to be severed from realty — Recording. — (1) A contract for the sale of minerals or the like (including oil and gas) or a structure or its materials to be removed from realty is a contract for the sale of goods within this chapter if they are to be severed by the seller but until severance a purported present sale thereof which is not effective as a transfer of an interest in land is effective only as a contract to sell.

(2) A contract for the sale apart from the land of growing crops or other things attached to realty and capable of severance without material harm thereto but not described in subsection (1) or of timber to be cut is a contract for the sale of goods within this chapter whether the subject matter is to be severed by the buyer or by the seller even though it forms part of the realty at the time of contracting, and the parties can by identification effect a present sale before severance.

(3) The provisions of this section are subject to any third party rights provided by the law relating to realty records, and the contract for sale may be executed and recorded as a document transferring an interest in land and shall then constitute notice to third parties of the buyer's rights under the contract for sale.

History.

1967, ch. 161, § 2-107, p. 351; am. 1979, ch. 299, § 2, p. 781.

STATUTORY NOTES

Compiler's Notes.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Cited Howard v. Estate of Howard, 112 Idaho 306, 732 P.2d 275 (1987).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 56 et seq.

68A Am. Jur. 2d, Secured Transactions, § 53 et seq.

Official Comment

Prior Uniform Statutory Provision: See Section 76, Uniform Sales Act on prior policy; Section 7, Uniform Conditional Sales Act.

Purposes: 1. Subsection (1). Notice that this subsection applies only if the minerals or structures "are to be severed by the seller." If the buyer is to sever, such transactions are considered contracts affecting land and all problems of the Statute of Frauds and of the recording of land rights apply to them. Therefore, the Statute of Frauds section of this Article [Chapter] does not apply to such contracts though they must conform to the Statute of Frauds affecting the transfer of interests in land.

2. Subsection (2). "Things attached" to the realty which can be severed without material harm are goods within this Article [Chapter] regardless of who is to effect the severance. The word "fixtures" has been avoided because of the diverse definitions of this term, the test of "severance without material harm" being substituted.

The provision in subsection (3) for recording such contracts is within the purview of this Article [Chapter] since it is a means of preserving the buyer's rights under the contract of sale.

3. The security phases of things attached to or to become attached to realty are dealt with in the Article [Chapter] on Secured Transactions (Article [Chapter] 9) and it is to be noted that the definition of goods in that Article [Chapter] differs from the definition of goods in this Article [Chapter].

However, both Articles [Chapters] treat as goods growing crops and also timber to be cut under a contract of severance.

Cross References: Point 1: Section 2-201.

Point 2: Section 2-105.

Point 3: Articles [Chapters] 9 and 9-105.

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Goods." Section 2-105.

"Party." Section 1-201.

"Present sale." Section 2-106.

"Rights." Section 1-201.

"Seller." Section 2-103.

Part 2
Form, Formation and Readjustment of Contract

• Title 28 •, « Ch. 2 », « Pt. 2 », • § 28-2-201 »

§ 28-2-201. Formal requirements — Statute of frauds. — (1) Except as otherwise provided in this section a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

(2) Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within ten (10) days after it is received.

(3) A contract which does not satisfy the requirements of subsection (1) but which is valid in other respects is enforceable (a) if the goods are to be specially manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business and the seller, before notice of repudiation is received and under circumstances which reasonably indicate that the goods are for the buyer, has made either a substantial beginning of their manufacture or commitments for their procurement; or (b) if the party against whom enforcement is sought admits in his pleading, testimony or otherwise in court that a contract for sale was made, but the contract is not enforceable under this provision beyond the quantity of goods admitted; or (c) with respect to goods for which payment has been made and accepted or which have been received and accepted (section 28-2-606[, Idaho Code]).

History.

1967, ch. 161, § 2-201, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion at the end of paragraph (3)(c) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Agreement to Contract.

A party cannot state an agreement to purchase goods on his own terms and, thereby, unilaterally form a contract. The seller must agree to sell the goods. D.R. Curtis Co. v. Mason, 103 Idaho 476, 649 P.2d 1232 (Ct. App. 1982).

Application.

The statute of frauds applies only to executory contracts, not those which have been performed. Beal v. Griffin, 123 Idaho 445, 849 P.2d 118 (Ct. App. 1993).

Where the defendant delivered and installed equipment, and the plaintiff paid for it, the issue before the court was one of warranties and guarantees, not whether the sale was enforceable under the statute of frauds. J.R. Simplot Co. v. Enviro-Clear Co., 132 Idaho 251, 970 P.2d 980 (1998).

If an agreement contains terms for the sale of goods and services, the contract is a hybrid contract. The test for whether a hybrid contract is subject to the UCC, and the statute of frauds, is whether the predominant factor, the thrust, the purpose of the agreement is a transaction of sale, with labor incidentally involved. Silicon Int'l Ore, LLC v. Monsato Co., 155 Idaho 538, 314 P.3d 593 (2013).

Contract Admitted in Testimony.

The Uniform Commercial Code provides that a contract not satisfying the statute of frauds is nonetheless enforceable if the party against who enforcement is sought admits in his testimony that a contract was made. Faw v. Greenwood, 101 Idaho 387, 613 P.2d 1338 (1980).

Defendant admitted, while testifying as an adverse party in plaintiff's case-in-chief, that defendant and plaintiff had entered into an agreement wherein defendant agreed to use plaintiff's potatoes to help fulfill a potato contract with a third party; therefore, there was substantial evidence that defendant and plaintiff had entered into an enforceable requirements contract. Mitchell v. Barendregt, 120 Idaho 837, 820 P.2d 707 (Ct. App. 1991).

Exceptions.

Where a man agreed to sell a truck to a corporation, but there was no written agreement, payment, transfer of title, use by the corporation or the like, the agreement did not fall within any of the exceptions to the statute of frauds and neither party could have enforced the contract of sale unless the other admitted that a contract had been made or unless the truck had been received and accepted. Keller Lorenz Co. v. Insurance Assocs. Corp., 98 Idaho 678, 570 P.2d 1366 (1977).

Existence of Contract.

Where buyer alleged the existence of a contract to purchase equipment and attached a copy of the bill of sale to his complaint, buyer could not rely upon the defense of the statute of frauds to avoid the enforcement of the contract. Christensen v. Ransom, 123 Idaho 99, 844 P.2d 1349 (Ct. App. 1992).

Where buyer recorded a bill of sale at the county recorder's office, gave the seller a check for $20,000, and buyer, three days later, asked the sellers

to sign a receipt for the $20,000 partial payment, there was substantial evidence to support the district court's findings of the existence of a contract. Christensen v. Ransom, 123 Idaho 99, 844 P.2d 1349 (Ct. App. 1992).

Surety's arguments concerning the statute of frauds misapprehended the issue, because the statute of frauds would only be relevant as a defense to show that the sub-subcontractor did not have a direct contractual relationship with the subcontractor and any applicable exception to the statute of frauds would depend upon the conduct of the sub-subcontractor and subcontractor; there was no requirement under § 54-1927 that the sub-subcontractor have any contractual relationship with the surety. Evco Sound & Elecs., Inc. v. Seaboard Sur. Co., 148 Idaho 357, 223 P.3d 740 (2009).

Part Performance.

Buyer's payment of $120, which was accepted by seller though later returned, constitutes sufficient part performance to excuse compliance with the statute of frauds. Paloukos v. Intermountain Chevrolet Co., 99 Idaho 740, 588 P.2d 939 (1978).

Part payment for a nondivisible unit, such as an automobile, permits the party under subsection (3)(c) of this section to prove and recover in full on the oral contract. Paloukos v. Intermountain Chevrolet Co., 99 Idaho 740, 588 P.2d 939 (1978).

Receipt and Acceptance.

Receipt and acceptance of goods is deemed to constitute an unambiguous overt admission by both parties that a contract actually exists and makes admissible oral evidence of other terms of the contract under the "receipt and acceptance" exception to the statute, a modified contract may be enforced to the extent of the goods that have been accepted; thus, whether the implied agreement between building contractor and building supplies company regarding conditions of payment is viewed as modifying the terms of the parties' initial contract, or as an agreement to terminate the initial contract and create a new, "original" contract, its enforcement is not barred by the statute of frauds. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Where the plaintiff accepted and paid for equipment, the requirement of a writing contained in subsection (1) of this provision was unnecessary. J.R. Simplot Co. v. Enviro-Clear Co., 132 Idaho 251, 970 P.2d 980 (1998).

Sufficiency of Terms.

Where agreement identified both parties, named the consideration, specified the model, make and serial number and was signed by both parties, this was sufficient for it to constitute a contract of sale even though it also allowed the seller, until buyer took possession, to sell to anyone else if he could get a higher price. Ace Supply, Inc. v. Rocky-Mountain Mach. Co., 96 Idaho 183, 525 P.2d 965 (1974).

Although the contract, between defendant and a potato purchaser, relied upon by the trial court, satisfied the statutory requirement of "a writing sufficient to indicate that a contract for sale" had been made between defendant and plaintiff, because plaintiff was named in the contract text, such writing was nevertheless insufficient to meet the "quantity of goods" requirement because it did not in any way specify quantity of potatoes as between plaintiff and defendant. Mitchell v. Barendregt, 120 Idaho 837, 820 P.2d 707 (Ct. App. 1991).

Buyer admitted the existence of a contract with a purchase price of $20,000. Buyer did not admit to a purchase price of $40,000. Though the admission prevented buyer from successfully asserting the statute of fraud as to the existence of a contract, it did not establish the terms of the contract. Christensen v. Ransom, 123 Idaho 99, 844 P.2d 1349 (Ct. App. 1992).

Written Confirmation.

Sending a memorandum of confirmation of purchase does not create an enforceable contract unless there existed a previous oral agreement to be confirmed and this is true notwithstanding an unconditional statement upon the written confirmation form noting that failure to return the form would be deemed an acceptance of the contract. No language in a "confirming memorandum" can create an agreement that did not previously exist. D.R. Curtis Co. v. Mason, 103 Idaho 476, 649 P.2d 1232 (Ct. App. 1982).

Where a grain farmer telephoned a grain brokerage company merely to explore the possibility of a sale, and the evidence showed that he did not

agree during the telephone conversation to sell his wheat at that time, the trial court properly found that no oral agreement was ever reached between the parties. The farmer's failure to return a "confirmation memorandum" sent to him by an agent for the brokerage company did not create an agreement that did not previously exist between the parties, even where the memorandum stated that its retention was an acknowledgment and acceptance of the contract. D.R. Curtis Co. v. Mason, 103 Idaho 476, 649 P.2d 1232 (Ct. App. 1982).

Cited Paloukos v. Intermountain Chevrolet Co., 99 Idaho 740, 588 P.2d 939 (1978); Smith v. Boise Kenworth Sales, Inc., 102 Idaho 63, 625 P.2d 417 (1981); Good v. Hansen, 110 Idaho 953, 719 P.2d 1213 (Ct. App. 1986); Baker v. Kulczyk, 112 Idaho 417, 732 P.2d 386 (Ct. App. 1987); Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Decisions Under Prior Law

Admissibility of Oral Evidence.

Evidence that owner had negotiated for sale of sheep for delivery on day bond was given was admissible, although not in writing, to establish market value of property at time bond was given, in an action for damages on a bond given to assure performance of injunction restraining disposal of such sheep. Beech v. American Sur. Co., 56 Idaho 159, 51 P.2d 213 (1935).

Application.

Statute did not apply to oral contract to purchase lumber ordered specifically and accepted in full by the buyers. Hoff Bldg. Supply v. Wright, 76 Idaho 298, 282 P.2d 478 (1955).

Contracts Voidable.

A contract falling within the statute of frauds is not void but voidable. Bevercombe v. Denney & Co., 40 Idaho 34, 231 P. 427 (1924).

Delivery of Goods.

Where statute was not complied with at the time sale was made, the contract could only be enforced against the purchaser if he afterwards received and accepted goods; but in case he did afterwards so receive and accept them, the contract became executed and the statute had no application. Coffin v. Bradbury, 3 Idaho 770, 35 P. 715 (1894).

Act of buyer of goods under a contract in offering to sell goods which he has contracted to purchase was such an act as constituted an acceptance of the goods so as to take contract out of the operation of the statute. Bicknell v. Owyhee Sheep & Land Co., 31 Idaho 696, 176 P. 782 (1918).

Letters as Contracts.

Where the contract was evidenced by a series of letters and telegrams interchanged by the parties, the duty of interpreting their meaning was properly referred to a jury. Idaho Hide & Fur Co. v. Portland Hide & Wool Co., 47 Idaho 615, 277 P. 572 (1929).

No Part Payment on Delivery.

Where essential part of a contract for sale of mining stock for more than $200 rested in parole, and there had been no delivery of any part of the property and no payment of any part of the purchase price, such contract was void. Snow Storm Mining Co. v. Johnson, 186 F. 745 (9th Cir. 1911).

Pleading.

Statute of frauds is a defense that may or may not be used, but is not available as a defense unless pleaded. Bevercombe v. Denney & Co., 40 Idaho 34, 231 P. 427 (1924).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 93.

67 Am. Jur. 2d, Sales, §§ 73 et seq.

C.J.S. — 77A C.J.S., Sales, § 106 et seq.

ALR. — Price fixed in contract violating statute of frauds as evidence of value in action on quantum meruit. 21 A.L.R.3d 9.

Construction and effect of affirmative provision in contract of sale by which purchaser agrees to take article "as is," in the condition in which it is, or equivalent term. 24 A.L.R.3d 465.

Applicability of statute of frauds to agreement to rescind contract for sale of land. 42 A.L.R.3d 242.

Action by employee in reliance on employment contract which violates statute of frauds as rendering contract enforceable. 54 A.L.R.3d 715.

Exceptions to rule that oral gifts of land are unenforceable under statute of frauds. 83 A.L.R.3d 1294.

Construction and application of UCC § 2-201(3)(b) rendering contract of sale enforceable notwithstanding statute of frauds to extent it is admitted in pleading, testimony, or otherwise in court. 88 A.L.R.3d 416.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Goods and Services: Distributorship, Franchise, and Similar Business Contracts. 8 A.L.R.7th 4.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Business Goods and Services: Manufacturing, Construction, and Similar Contracts. 15 A.L.R.7th 7.

Official Comment

Prior Uniform Statutory Provision: Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29 Charles II).

Changes: Completely rephrased; restricted to sale of goods. See also Sections 1-206, 8-319 and 9-203.

Purposes of Changes: The changed phraseology of this section is intended to make it clear that: 1. The required writing need not contain all the material terms of the contract and such material terms as are stated need not be precisely stated. All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real transaction. It

may be written in lead pencil on a scratch pad. It need not indicate which party is the buyer and which the seller. The only term which must appear is the quantity term which need not be accurately stated but recovery is limited to the amount stated. The price, time and place of payment or delivery, the general quality of the goods, or any particular warranties may all be omitted.

Special emphasis must be placed on the permissibility of omitting the price term in view of the insistence of some courts on the express inclusion of this term even where the parties have contracted on the basis of a published price list. In many valid contracts for sale the parties do not mention the price in express terms, the buyer being bound to pay and the seller to accept a reasonable price which the trier of the fact may well be trusted to determine. Again, frequently the price is not mentioned since the parties have based their agreement on a price list or catalogue known to both of them and this list serves as an efficient safeguard against perjury. Finally, "market" prices and valuations that are current in the vicinity constitute a similar check. Thus if the price is not stated in the memorandum it can normally be supplied without danger of fraud. Of course if the "price" consists of goods rather than money the quantity of goods must be stated.

Only three definite and invariable requirements as to the memorandum are made by this subsection. First, it must evidence a contract for the sale of goods; second, it must be "signed," a word which includes any authentication which identifies the party to be charged; and third, it must specify a quantity.

2. "Partial performance" as a substitute for the required memorandum can validate the contract only for the goods which have been accepted or for which payment has been made and accepted.

Receipt and acceptance either of goods or of the price constitutes an unambiguous overt admission by both parties that a contract actually exists. If the court can make a just apportionment, therefore, the agreed price of any goods actually delivered can be recovered without a writing or, if the price has been paid, the seller can be forced to deliver an apportionable part of the goods. The overt actions of the parties make admissible evidence of the other terms of the contract necessary to a just apportionment. This is

true even though the actions of the parties are not in themselves inconsistent with a different transaction such as a consignment for resale or a mere loan of money.

Part performance by the buyer requires the delivery of something by him that is accepted by the seller as such performance. Thus, part payment may be made by money or check, accepted by the seller. If the agreed price consists of goods or services, then they must also have been delivered and accepted.

3. Between merchants, failure to answer a written confirmation of a contract within ten days of receipt is tantamount to a writing under subsection (2) and is sufficient against both parties under subsection (1). The only effect, however, is to take away from the party who fails to answer the defense of the Statute of Frauds; the burden of persuading the trier of fact that a contract was in fact made orally prior to the written confirmation is unaffected. Compare the effect of a failure to reply under Section 2-207.

4. Failure to satisfy the requirements of this section does not render the contract void for all purposes, but merely prevents it from being judicially enforced in favor of a party to the contract. For example, a buyer who takes possession of goods as provided in an oral contract which the seller has not meanwhile repudiated, is not a trespasser. Nor would the Statute of Frauds provisions of this section be a defense to a third person who wrongfully induces a party to refuse to perform an oral contract, even though the injured party cannot maintain an action for damages against the party so refusing to perform.

5. The requirement of "signing" is discussed in the comment to Section 1-201.

6. It is not necessary that the writing be delivered to anybody. It need not be signed or authenticated by both parties but it is, of course, not sufficient against one who has not signed it. Prior to a dispute no one can determine which party's signing of the memorandum may be necessary but from the time of contracting each party should be aware that to him it is signing by the other which is important.

7. If the making of a contract is admitted in court, either in a written pleading, by stipulation or by oral statement before the court, no additional

writing is necessary for protection against fraud. Under this section it is no longer possible to admit the contract in court and still treat the Statute as a defense. However, the contract is not thus conclusively established. The admission so made by a party is itself evidential against him of the truth of the facts so admitted and of nothing more; as against the other party, it is not evidential at all.

Cross References: See Sections 1-201, 2-202, 2-207, 2-209 and 2-304.

Definitional Cross References: "Action." Section 1-201.

"Between merchants." Section 2-104.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Goods." Section 2-105.

"Notice." Section 1-201.

"Party." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Sale." Section 2-106.

"Seller." Section 2-103.

§ 28-2-202. Final written expression — Parol or extrinsic evidence. — Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

(a) By course of performance, course of dealing, or usage of trade (section 28-1-303[, Idaho Code]); and

(b) By evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

History.

1967, ch. 161, § 2-202, p. 351; am. 2004, ch. 43, § 29, p. 136.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion near the end of paragraph (a) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Subsequent oral agreement.

Applicability.

This section only applies where the confirmatory memoranda agree; when the confirmatory memoranda conflict, § 28-2-207 is applicable. Airstream, Inc. v. CIT Fin. Servs., Inc., 111 Idaho 307, 723 P.2d 851 (1986).

The parol evidence rule is inapplicable to conflicting statements made after the parties entered a sale agreement; this rule excludes only extrinsic evidence of agreements or understandings that precede or are contemporaneous with the written contract and does not preclude evidence of agreements or statements made after the writing. Herrick v. Leuzinger, 127 Idaho 293, 900 P.2d 201 (Ct. App. 1995).

Consistent Terms.

Where creditor testified that he and general manager of debtor orally agreed that if debtor could not sell the tractor to a third party for more than the agreed contract price, then creditor would take the tractor, and this parol evidence did not contradict the sale agreement between creditor and debtor, it was properly admissible. Ace Supply, Inc. v. Rocky-Mountain Mach. Co., 96 Idaho 183, 525 P.2d 965 (1974).

Where a promised delivery date was not contradictory to, nor did it negate, the written agreement the parties entered into, it would be a "consistent additional term" that would be admissible subject to the proviso that the purchase agreement was not intended as a complete and exclusive statement of the terms of the agreement. Anderson & Nafziger v. G.T. Newcomb, Inc., 100 Idaho 175, 595 P.2d 709 (1979).

Where a sales agreement provided that a bankruptcy trustee sold all assets of a bankruptcy debtor located at a restaurant to the debtor's landlord, but the trustee subsequently asserted that prior emails between the trustee and the landlord indicated that the trustee did not intend to sell certain equipment, the sales agreement with a merger clause was binding; parol evidence was not available to add terms to the agreement since the emails did not resolve whether the equipment was included in the sale and, in any event, additional terms to exclude the equipment were not consistent with the agreement. Bankr. Estate of Wing Foods, Inc. v. CCF Leasing Co. (In re Wing Foods), 2010 Bankr. LEXIS 114 (Bankr. D. Idaho Jan. 14, 2010).

In General.

This section is not necessarily a statement of a parol evidence rule distinct from the common law, but rather it intended to incorporate the common law relevant to the parol evidence rule unless the common law was specifically excluded. Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 541 P.2d 1184 (1975).

Intent of Parties.

The intent of the parties to a contract must be derived from all the documents employed, the circumstances surrounding their execution, and the subsequent conduct of the parties. Interform Co. v. Mitchell, 575 F.2d 1270 (9th Cir. 1978).

Legislative Intent.

In analyzing whether the parties intended a purchase order as a "complete and exclusive statement of the terms of the agreement" the trial court should bear in mind that this section was intended to liberalize the parol evidence rule and to abolish the presumption that a writing is a total integration. This section requires that the court make a definite finding that the parties intended a total integration, before consistent additional terms are to be excluded. Anderson & Nafziger v. G.T. Newcomb, Inc., 100 Idaho 175, 595 P.2d 709 (1979).

Proper Admission of Extrinsic Evidence.

The determination of whether a writing is a complete and exclusive statement of the terms of the agreement should not be confined to a simple scanning of what terms the writing embodies. Instead the trial court should consider not only the language of the agreement but all extrinsic evidence relevant to the issue of whether the parties intended the written agreement to be a complete integration. Anderson & Nafziger v. G.T. Newcomb, Inc., 100 Idaho 175, 595 P.2d 709 (1979).

This section permits the introduction of parol evidence to explain or supplement through evidence of consistent additional terms, unless the court finds the writing was intended as a complete and exclusive statement of the terms of the agreement. Anderson & Nafziger v. G.T. Newcomb, Inc., 100 Idaho 175, 595 P.2d 709 (1979).

Only if the writing is determined to be the final written expression of the parties' agreement does the parol evidence rule apply to exclude evidence of conflicting or additional terms. Therefore, in view of the magistrate's finding that the parties in fact agreed to make building contractor's obligation subject to a condition — a term inconsistent with the written term contained in the invoice requiring payment on the tenth day of the month following delivery — the writing was not intended by the parties as the final expression of the agreed upon terms and accordingly, the magistrate's decision to consider extrinsic evidence to determine the terms of the parties' agreement was not erroneous. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

A bill of sale for cattle from plaintiffs' predecessors to the defendants provided no basis for exclusion of parol evidence where evidence showed bill was not a conveyance but was a device used to clear title to the cattle. Herrick v. Leuzinger, 127 Idaho 293, 900 P.2d 201 (Ct. App. 1995).

Trial court did not err in admitting into evidence preliminary negotiations between the parties regarding the number and dates of proposed deliveries because the contract did not contain a merger clause to indicate that it was meant as the complete and exclusive statement of the terms. The negotiations were admissible because they were made prior to or contemporaneous with the contract and were consistent with its terms. Borah v. McCandless, 147 Idaho 73, 205 P.3d 1209 (2009).

Subsequent Oral Agreement.

Inasmuch as the parol evidence rule bars only a prior or contemporaneous oral agreement relating to the same subject matter, seller's evidence as to difference between commissions charged on lumber as stated in the written contract and as subsequently billed was admissible as evidence as either (a) an oral modification of a written agreement, or (b) a new oral contract, or (c) an offer by seller to provide additional services for additional compensation. Brewer v. Pitkin, 99 Idaho 114, 577 P.2d 1162 (1978).

Cited Paloukos v. Intermountain Chevrolet Co., 99 Idaho 740, 588 P.2d 939 (1978); Gebrueder Heidemann, K.G. v. A.M.R. Corp., 107 Idaho 275, 688 P.2d 1180 (1984).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 34 et seq.

67 Am. Jur. 2d, Sales, § 73 et seq.

ALR. — Applicability of parol evidence rule in favor of or against one not a party to contract of release. 13 A.L.R.3d 313.

Admissibility of parol evidence to show whether guaranty of corporation's obligation was signed in officer's representative or individual capacity. 70 A.L.R.3d 1276.

Application of parol evidence rule of UCC § 2-202 where fraud or misrepresentation is claimed in sale of goods. 71 A.L.R.3d 1059.

Modern status of rules governing legal effect of failure to object to admission of extrinsic evidence violative of parol evidence rule. 81 A.L.R.3d 249.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Goods and Services: Distributorship, Franchise, and Similar Business Contracts. 8 A.L.R.7th 4.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Business Goods and Services: Manufacturing, Construction, and Similar Contracts. 15 A.L.R.7th 7.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. This section definitely rejects:

(a) Any assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon;

(b) The premise that the language used has the meaning attributable to such language by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used; and

(c) The requirement that a condition precedent to the admissibility of the type of evidence specified in paragraph (a) is an original determination by the court that the language used is ambiguous.

2. Paragraph (a) makes admissible evidence of course of dealing, usage of trade and course of performance to explain or supplement the terms of any writing stating the agreement of the parties in order that the true understanding of the parties as to the agreement may be reached. Such writings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used. Similarly, the course of actual performance by the parties is considered the best indication of what they intended the writing to mean.

3. Under paragraph (b) consistent additional terms, not reduced to writing, may be proved unless the court finds that the writing was intended by both parties as a complete and exclusive statement of all the terms. If the additional terms are such that, if agreed upon, they would certainly have been included in the document in the view of the court, then evidence of their alleged making must be kept from the trier of fact.

Cross References: Point 3: Sections 1-303, 2-207, 2-302 and 2-316.

Definitional Cross References: "Agreed" and "agreement." Section 1-201.

"Course of dealing." Section 1-303.

"Course of performance." Section 1-303.

"Party." Section 1-201.

"Term." Section 1-201.

"Usage of trade." Section 1-303.

"Written" and "writing." Section 1-201.

§ 28-2-203. Seals inoperative. — The affixing of a seal to a writing evidencing a contract for sale or an offer to buy or sell goods does not constitute the writing a sealed instrument and the law with respect to sealed instruments does not apply to such a contract or offer.

History.

1967, ch. 161, § 2-203, p. 569.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 104.

Official Comment

Prior Uniform Statutory Provision: Section 3, Uniform Sales Act.

Changes: Portion pertaining to "seals" rewritten.

Purposes of Changes: 1. This section makes it clear that every effect of the seal which relates to "sealed instruments" as such is wiped out insofar as contracts for sale are concerned. However, the substantial effects of a seal, except extension of the period of limitations, may be had by appropriate drafting as in the case of firm offers (see Section 2-205).

2. This section leaves untouched any aspects of a seal which relate merely to signatures or to authentication of execution and the like. Thus, a statute providing that a purported signature gives prima facie evidence of its own authenticity or that a signature gives prima facie evidence of consideration is still applicable to sales transactions even though a seal may be held to be a signature within the meaning of such a statute. Similarly, the authorized affixing of a corporate seal bearing the corporate name to a contractual writing purporting to be made by the corporation may have effect as a signature without any reference to the law of sealed instruments.

Cross Reference: Point 1: Section 2-205.

Definitional Cross References: "Contract for sale." Section 2-106.

"Goods." Section 2-105.

“Writing.” Section 1-201.

§ 28-2-204. Formation in general. — (1) A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.

(2) An agreement sufficient to constitute a contract for sale may be found even though the moment of its making is undetermined.

(3) Even though one or more terms are left open a contract for sale does not fail for indefiniteness if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.

History.

1967, ch. 161, § 2-204, p. 351.

CASE NOTES

Action to Determine Reasonable Figure.

Where parties contracted for sale of wheat and left a factor in the price open to be agreed upon at a later date, the fact that this term was left open to be established by the parties at a later date and the parties failed to reach agreement on the figure did not make the contract ambiguous or void for indefiniteness but simply meant that a reasonable figure remained to be determined, therefore when the defendant sold the wheat to third party he

breached the contract. D.R. Curtis Co. v. Mathews, 103 Idaho 776, 653 P.2d 1188 (Ct. App. 1982).

Acquiescence to New Terms.

Where at the onset of the parties' transaction, contractor informed supplier that third party presented a risk of nonpayment, and supplier agreed to provide "priced-out" invoices at delivery in order to allow contractor to immediately obtain payment from third party, but supplier failed to properly tender the goods by delivering them without the requisite priced-out invoices, and supplier told contractor to go ahead and unload the materials without the pricing information, based upon this conduct, and from the surrounding circumstances, the magistrate reasonably could construe contractor's unequivocal refusal to be responsible without the pricing information, followed by supplier's authorization to unload the materials, as supplier's assent, or acquiescence, to contractor's proposed new terms, i.e., that contractor would not be liable if he could not collect from third party. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Agreement to Contract.

A party cannot state an agreement to purchase goods on his own terms, and thereby unilaterally form a contract. The seller must agree to sell the goods. D.R. Curtis Co. v. Mason, 103 Idaho 476, 649 P.2d 1232 (Ct. App. 1982).

Facts Held Insufficient to Show Contract.

Where neither party signed the purchase order for truck in the designated spaces, buyer understood that he could "bow out" of the transaction at any time he so desired, seller stated its intention to retain the truck as inventory in the event buyer did not want it, and seller continued to make changes in factory specifications at buyer's request, there was no conduct sufficient to show an agreement under subsection (1) of this section. Even if an agreement did exist, it would fail for indefiniteness, since as a matter of law there could be no reasonably certain basis for giving an appropriate remedy under subsection (3) of this section. Smith v. Boise Kenworth Sales, Inc., 102 Idaho 63, 625 P.2d 417 (1981).

Where a grain farmer telephoned a grain brokerage company merely to explore the possibility of a sale, and the evidence showed that he did not agree during the telephone conversation to sell his wheat at that time, the trial court properly found that no oral agreement was ever reached between the parties. The farmer's failure to return a "confirmation memorandum" sent to him by an agent for the brokerage company did not create an agreement that did not previously exist between the parties, even where the memorandum stated that its retention was an acknowledgment and acceptance of the contract. D.R. Curtis Co. v. Mason, 103 Idaho 476, 649 P.2d 1232 (Ct. App. 1982).

Verbal agreement for the purchase of sand failed for indefiniteness, because the agreement's essential terms were vague and indefinite, or altogether absent; the price was set at "agreed-upon amounts" and the quantity was set at "agreed-upon quantities." Silicon Int'l Ore, LLC v. Monsato Co., 155 Idaho 538, 314 P.3d 593 (2013).

Facts Held Sufficient to Show Contract.

Buyer has alleged facts which indicate that he and seller agreed to the sale of the pickup, that salesman completed a form which — though not entirely complete — described the truck buyer desired and stated a price, that buyer signed the completed form, that the sale was approved by a sales manager, that buyer was told the truck would be ordered for him, and that seller accepted and retained for several months a deposit on the truck; these facts could support a conclusion by a trier of fact that under this section the parties intended to enter into a binding contract and could form a "reasonably certain basis for giving an appropriate remedy." Paloukos v. Intermountain Chevrolet Co., 99 Idaho 740, 588 P.2d 939 (1978).

District court did not err in concluding that a valid contract had been formed between a trout hatchery and a trout grower and that any disagreement between the parties regarding "market size" was not so fundamental as to have gone to the heart of the very essence of the contract. Griffith v. Clear Lakes Trout Co., 143 Idaho 733, 152 P.3d 604 (2007).

District court did not err in finding that the language in an agreement between a trout hatchery and a trout grower regarding the "typical" number of harvests and the need for "continuous and uniform delivery" were sufficient to indicate an implied obligation to take deliveries within a

reasonable time and with limited frequency. Griffith v. Clear Lakes Trout Co., 143 Idaho 733, 152 P.3d 604 (2007).

In General.

In order to have an enforceable contract, the UCC does not require a document itemizing all the specific terms of the agreement; rather, the UCC requires a determination whether the circumstances of the case, including the parties' conduct, are "sufficient to show agreement." Paloukos v. Intermountain Chevrolet Co., 99 Idaho 740, 588 P.2d 939 (1978).

When Contract Made.

A contract can be found to exist even where it is impossible to determine when the contract was made. Essex Crane Rental Corp. v. Weyher/Livsey Constructors, Inc., 713 F. Supp. 1350 (D. Idaho 1989), rev'd on other grounds, 940 F.2d 1253 (9th Cir. 1991).

Written Confirmation.

Sending a memorandum of confirmation of purchase does not create an enforceable contract unless there existed a previous oral agreement to be confirmed and this is true notwithstanding an unconditional statement upon the written confirmation form noting that failure to return the form would be deemed an acceptance of the contract. No language in a "confirming memorandum" can create an agreement that did not previously exist. D.R. Curtis Co. v. Mason, 103 Idaho 476, 649 P.2d 1232 (Ct. App. 1982).

Cited Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977); Harvey v. Fearless Farris Whsle., Inc., 589 F.2d 451 (9th Cir. 1979); Anderson & Nafziger v. G.T. Newcomb, Inc., 100 Idaho 175, 595 P.2d 709 (1979); Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983).

Decisions Under Prior Law

Agreement to purchase note.

Cash sale.

Executed and executory contracts.

Offer and acceptance.

Stipulation to reduce to writing.

Agreement to Purchase Note.

Agreement to purchase certain note upon written demand, and to pay for such note its full face value and accruing interest, was not a sales contract, but a promise to pay on demand the sum named. Wallace Bank & Trust Co. v. First Nat'l Bank, 40 Idaho 712, 237 P. 284 (1925).

Cash Sale.

A "cash sale" is one where payment and delivery are to be concurrent. Western Seed Marketing Co. v. Pfost, 45 Idaho 340, 262 P. 514 (1927).

Executed and Executory Contracts.

If the risk of loss from injury to, or destruction of, the property was on the buyer, the contract was executed, and, if on the seller, it was executory. Western Seed Marketing Co. v. Pfost, 45 Idaho 340, 262 P. 514 (1927); Peterson v. Universal Auto. Ins. Co., 53 Idaho 11, 20 P.2d 1016 (1933).

Offer and Acceptance.

Word "accepted" signed by buyer on offer in writing to sell definite quantity of certain article constituted valid contract of sale. O.A. Olin Co. v. Lambach, 35 Idaho 767, 209 P. 277 (1922).

Stipulation to Reduce to Writing.

If the parties to an oral agreement stipulated that the contract should be reduced to writing, the question of whether there was a valid contract between the parties before it was reduced to writing depended upon the intention of the parties. Elliott v. Pope, 42 Idaho 505, 247 P. 796 (1926).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 34 et seq.

67 Am. Jur. 2d, Sales, § 98 et seq.

ALR. — Applicability of UCC Article 2 to Mixed Contracts for Sale of Goods and Services: Distributorship, Franchise, and Similar Business Contracts. 8 A.L.R.7th 4.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Business Goods and Services: Manufacturing, Construction, and Similar Contracts. 15 A.L.R.7th 7.

Official Comment

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article [Chapter].

Purposes of Changes: Subsection (1) continues without change the basic policy of recognizing any manner of expression of agreement, oral, written or otherwise. The legal effect of such an agreement is, of course, qualified by other provisions of this Article [Chapter].

Under subsection (1) appropriate conduct by the parties may be sufficient to establish an agreement. Subsection (2) is directed primarily to the situation where the interchanged correspondence does not disclose the exact point at which the deal was closed, but the actions of the parties indicate that a binding obligation has been undertaken.

Subsection (3) states the principle as to “open terms” underlying later sections of the Article [Chapter]. If the parties intend to enter into a binding agreement, this subsection recognizes that agreement as valid in law, despite missing terms, if there is any reasonably certain basis for granting a remedy. The test is not certainty as to what the parties were to do nor as to the exact amount of damages due the plaintiff. Nor is the fact that one or more terms are left to be agreed upon enough of itself to defeat an otherwise adequate agreement. Rather, commercial standards on the point of “indefiniteness” are intended to be applied, this Act making provision elsewhere for missing terms needed for performance, open price, remedies and the like.

The more terms the parties leave open, the less likely it is that they have intended to conclude a binding agreement, but their actions may be frequently conclusive on the matter despite the omissions.

Cross References: Subsection (1): Sections 1-103, 2-201 and 2-302.

Subsection (2): Sections 2-205 through 2-209.

Subsection (3): See Part 3.

Definitional Cross References: "Agreement." Section 1-201.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Goods." Section 2-105.

"Party." Section 1-201.

"Remedy." Section 1-201.

"Term." Section 1-201.

§ 28-2-205. Firm offers. — An offer by a merchant to buy or sell goods in a signed writing which by its terms gives assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplies [supplied] by the offeree must be separately signed by the offeror.

History.

1967, ch. 161, § 2-205, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion near the end of the section was added by the compiler to supply the obviously intended term.

CASE NOTES

Sale to Another.

Where agreement identified both parties, named the consideration, specified the model, make and serial number and was signed by both parties, this was sufficient for it to constitute a contract of sale, even though it also allowed the seller, until buyer took possession, to sell to anyone else if he could get a higher price. Ace Supply, Inc. v. Rocky-Mountain Mach. Co., 96 Idaho 183, 525 P.2d 965 (1974).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 132.

Official Comment

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article [Chapter].

Purposes of Changes: 1. This section is intended to modify the former rule which required that "firm offers" be sustained by consideration in order to bind, and to require instead that they must merely be characterized as such and expressed in signed writings.

2. The primary purpose of this section is to give effect to the deliberate intention of a merchant to make a current firm offer binding. The deliberation is shown in the case of an individualized document by the merchant's signature to the offer, and in the case of an offer included on a form supplied by the other party to the transaction by the separate signing of the particular clause which contains the offer. "Signed" here also includes authentication but the reasonableness of the authentication herein allowed must be determined in the light of the purpose of the section. The circumstances surrounding the signing may justify something less than a formal signature or initialing but typically the kind of authentication involved here would consist of a minimum of initialing of the clause involved. A handwritten memorandum on the writer's letterhead purporting in its terms to "confirm" a firm offer already made would be enough to satisfy this section, although not subscribed, since under the circumstances it could not be considered a memorandum of mere negotiation and it would adequately show its own authenticity. Similarly, an authorized telegram will suffice, and this is true even though the original draft contained only a typewritten signature. However, despite settled courses of dealing or usages of the trade whereby firm offers are made by oral communication and relied upon without more evidence, such offers remain revocable under this Article [Chapter] since authentication by a writing is the essence of this section.

3. This section is intended to apply to current "firm" offers and not to long term options, and an outside time limit of three months during which such offers remain irrevocable has been set. The three month period during which firm offers remain irrevocable under this section need not be stated by days or by date. If the offer states that it is "guaranteed" or "firm" until the happening of a contingency which will occur within the three month period, it will remain irrevocable until that event. A promise made for a longer period will operate under this section to bind the offeror only for the

first three months of the period but may of course be renewed. If supported by consideration it may continue for as long as the parties specify. This section deals only with the offer which is not supported by consideration.

4. Protection is afforded against the inadvertent signing of a firm offer when contained in a form prepared by the offeree by requiring that such a clause be separately authenticated. If the offer clause is called to the offeror's attention and he separately authenticates it, he will be bound; Section 2-302 may operate, however, to prevent an unconscionable result which otherwise would flow from other terms appearing in the form.

5. Safeguards are provided to offer relief in the case of material mistake by virtue of the requirement of good faith and the general law of mistake.

Cross References: Point 1: Section 1-102.

Point 2: Section 1-102.

Point 3: Section 2-201.

Point 5: Section 2-302.

Definitional Cross References: "Goods." Section 2-105.

"Merchant." Section 2-104.

"Signed." Section 1-201.

"Writing." Section 1-201.

§ 28-2-206. Offer and acceptance in formation of contract. — (1) Unless otherwise unambiguously indicated by the language or circumstances

(a) an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances; (b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or nonconforming goods, but such a shipment of nonconforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

(2) Where the beginning of a requested performance is a reasonable mode of acceptance an offeror who is not notified of acceptance within a reasonable time may treat the offer as having lapsed before acceptance.

History.

1967, ch. 161, § 2-206, p. 351.

CASE NOTES

Additional Terms.

Where the facts disclosed that when the buyer required fish food it would send a purchase order to the seller, the seller would reply by shipping the feed and including an invoice which was signed by one of the buyer's employees acknowledging receipt of the fish food, and the invoices accompanying the shipments from the seller provided for late finance charges, which was a term beyond that contained in the purchase order, the additional provision relating to late charge was not a material alteration of the contract, and the buyer's actions in continuing to order and pay for the feed constituted a waiver of its right to object to the additional late charge term. Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983).

Offer and Acceptance.

Where truck purchase order specified that it would become binding only when signed by person authorized by distributor, there was no acceptance of an offer, and thus no contract, where neither party signed the customer's purchase order in the space designated for acceptance, even though defendant truck distributor responded to plaintiff's solicitations by ordering the truck from the assembly plant. Smith v. Boise Kenworth Sales, Inc., 102 Idaho 63, 625 P.2d 417 (1981).

The fact that the lessee of a crane used the crane can, standing alone, establish acceptance of a lease offer by lessor. Essex Crane Rental Corp. v. Weyher/Livsey Constructors, Inc., 713 F. Supp. 1350 (D. Idaho 1989), rev'd on other grounds, 940 F.2d 1253 (9th Cir. 1991).

Decisions Under Prior Law

Offer and Acceptance.

Word "accepted" signed by buyer on offer in writing to sell definite quantity of certain article constituted valid contract of sale. O.A. Olin Co. v. Lambach, 35 Idaho 767, 209 P. 277 (1922).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 124 et seq.

ALR. — Advertisement addressed to public relating to sale or purchase of goods at specified price as an offer the acceptance of which will consummate a contract. 43 A.L.R.3d 1102.

Farmers as "merchants" within provisions of UCC Article 2, dealing with sales. 95 A.L.R.3d 484.

Official Comment

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten in this and other sections of this Article [Chapter].

Purposes of Changes: To make it clear that: 1. Any reasonable manner of acceptance is intended to be regarded as available unless the offeror has made quite clear that it will not be acceptable. Former technical rules as to acceptance, such as requiring that telegraphic offers be accepted by telegraphed acceptance, etc., are rejected and a criterion that the acceptance be "in any manner and by any medium reasonable under the circumstances," is substituted. This section is intended to remain flexible and its applicability to be enlarged as new media of communication develop or as the more time-saving present day media come into general use.

2. Either shipment or a prompt promise to ship is made a proper means of acceptance of an offer looking to current shipment. In accordance with ordinary commercial understanding the section interprets an order looking to current shipment as allowing acceptance either by actual shipment or by a prompt promise to ship and rejects the artificial theory that only a single mode of acceptance is normally envisaged by an offer. This is true even though the language of the offer happens to be "ship at once" or the like. "Shipment" is here used in the same sense as in Section 2-504; it does not include the beginning of delivery by the seller's own truck or by messenger. But loading on the seller's own truck might be a beginning of performance under subsection (2).

3. The beginning of performance by an offeree can be effective as acceptance so as to bind the offeror only if followed within a reasonable time by notice to the offeror. Such a beginning of performance must unambiguously express the offeree's intention to engage himself. For the protection of both parties it is essential that notice follow in due course to constitute acceptance. Nothing in this section however bars the possibility that under the common law performance begun may have an intermediate effect of temporarily barring revocation of the offer, or at the offeror's option, final effect in constituting acceptance.

4. Subsection (1)(b) deals with the situation where a shipment made following an order is shown by a notification of shipment to be referable to that order but has a defect. Such a nonconforming shipment is normally to be understood as intended to close the bargain, even though it proves to have been at the same time a breach. However, the seller by stating that the shipment is nonconforming and is offered only as an accommodation to the buyer keeps the shipment or notification from operating as an acceptance.

Definitional Cross References: "Buyer." Section 2-103.

"Conforming." Section 2-106.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Notifies." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

§ 28-2-207. Additional terms in acceptance or confirmation. — (1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless: (a) the offer expressly limits acceptance to the terms of the offer; (b) they materially alter it; or

(c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this act.

History.

1967, ch. 161, § 2-207, p. 351.

STATUTORY NOTES

Compiler's Notes.

The words "this act" at the end of subsection (3) refer to S. L. 1967, ch. 161, which is generally compiled as chapters 1 to 10 of this title. The reference probably should be to the Uniform Commercial Code.

CASE NOTES

Acceptance as CounterOffer.

A purported acceptance with terms which differ from the offer can sometimes be construed as a counteroffer, and sometimes the terms of the counteroffer will be considered terms of the contract; however, an acceptance to operate in this manner must be sent to the offeror. Essex Crane Rental Corp. v. Weyher/Livsey Constructors, Inc., 713 F. Supp. 1350 (D. Idaho 1989), rev'd on other grounds, 940 F.2d 1253 (9th Cir. 1991).

Applicability.

Section 28-2-202 only applies where the confirmatory memoranda agree; when the confirmatory memoranda conflict, this section is applicable. Airstream, Inc. v. CIT Fin. Servs., Inc., 111 Idaho 307, 723 P.2d 851 (1986).

Conflicting Terms.

Where a contract is formed by conflicting documents, the conflicting terms cancel out and the contract then consists of the terms upon which both parties expressly agree, with the contested terms being supplied by other sections of the Uniform Commercial Code. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

If an acceptance includes terms which are in conflict with the terms of the offer, the conflicting terms cancel out, and the court may supply terms based upon other sources under the UCC, such as course of dealing and

trade usage. Essex Crane Rental Corp. v. Weyher/Livsey Constructors, Inc., 713 F. Supp. 1350 (D. Idaho 1989), rev'd on other grounds, 940 F.2d 1253 (9th Cir. 1991).

Date.

Where an acceptance stated a different delivery date than that proposed in the offer, but the alteration did not constitute a radical change and the evidence indicated that the offeror had acquiesced to the change, the acceptance created a binding contract. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

Where the acceptance of an offer changed the delivery date, the conflicting terms on delivery canceled out and the term must be supplied by reference to § 28-2-309 which provided that delivery would be within a "reasonable" time. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

Finance Charges.

Additional terms contained in invoices assessing finance charges were not material alterations of contract between contractor and the lessor and lessee of farm; because this was a contract between merchants and none of the exceptions of subsections (2)(a), (b) or (c) of this section applied, the additional terms regarding finance charges became part of the contract. Tri-Circle, Inc. v. Brugger Corp., 121 Idaho 950, 829 P.2d 540 (Ct. App. 1992).

In General.

An acceptance which contains terms contradictory to those of the offer is not generally invalid although, in an exceptional case, an acceptance might differ so radically from the terms of an offer as not to manifest sufficient agreement to the offer to create a contract. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

This section rejects the common-law mirror image rule and converts the common-law counteroffer into an acceptance. Southern Idaho Pipe & Steel

Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

Material Alteration.

Additional or different terms will not become part of an agreement if they materially alter the original bargain. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Where additional terms in a written contract which purported to confirm the parties' prior oral agreement materially altered the terms of that agreement since they affected the price, schedule or payment, who to pay, and the risk of loss during delivery, the contradicting terms would not become part of the formal agreement. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Purpose.

This section was designed primarily to render equity in cases where an acceptance contained additional or different terms and performance had not yet begun. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

Seasonable Expression of Acceptance.

Where a purchase order referred to and accepted the price quoted in the offer, requested shipment within the time limits specified by the seller, and no other correspondence ensued and the regulator was shipped and installed accordingly, in commercial transactions such an order, especially when followed by performance, would normally be understood to have closed the deal between the parties; consequently, it was a "seasonable expression of acceptance," even though it contained the additional terms. Idaho Power Co. v. Westinghouse Elec. Corp., 596 F.2d 924 (9th Cir. 1979).

Acceptance with additional terms must be sent to the offeror within a reasonable time; two months after the lessee takes possession of the property is not reasonable. Essex Crane Rental Corp. v. Weyher/Livsey Constructors, Inc., 713 F. Supp. 1350 (D. Idaho 1989), rev'd on other grounds, 940 F.2d 1253 (9th Cir. 1991).

Terms Unaltered.

A purchase order form which stated: "Acceptance of this order shall be deemed to constitute an agreement to the conditions named hereon and supersedes all previous agreements," did not alter the terms of the offer. Idaho Power Co. v. Westinghouse Elec. Corp., 596 F.2d 924 (9th Cir. 1979).

Waiver of Right to Object.

Where the facts disclosed that when the buyer required fish food it would send a purchase order to the seller, the seller would reply by shipping the feed and including an invoice which was signed by one of the buyer's employees acknowledging receipt of the fish food, and the invoices accompanying the shipments from the seller provided for late finance charges, which was a term beyond that contained in the purchase order, the additional provision relating to late charges was not a material alteration of the contract, and the buyer's actions in continuing to order and pay for the feed constituted a waiver of its right to object to the additional late charge term. Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983).

Cited Investment Serv. Co. v. Roper, 588 F.2d 764 (9th Cir. 1978); Gebrueder Heidemann, K.G. v. A.M.R. Corp., 107 Idaho 275, 688 P.2d 1180 (1984); Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 142 et seq.

ALR. — What are additional terms materially altering contracts within meaning of UCC § 2-207(2)(b). 72 A.L.R.3d 479.

Conditional acceptance, conversion to rejection and counteroffer under UCC § 2-207(1). 22 A.L.R.4th 939.

Official Comment

Prior Uniform Statutory Provision: Sections 1 and 3, Uniform Sales Act.

Changes: Completely rewritten by this and other sections of this Article [Chapter].

Purposes of Changes: 1. This section is intended to deal with two typical situations. The one is the written confirmation, where an agreement has been reached either orally or by informal correspondence between the parties and is followed by one or both of the parties sending formal memoranda embodying the terms so far as agreed upon and adding terms not discussed. The other situation is offer and acceptance, in which a wire or letter expressed and intended as an acceptance or the closing of an agreement adds further minor suggestions or proposals such as "ship by Tuesday," "rush," "ship draft against bill of lading inspection allowed," or the like. A frequent example of the second situation is the exchange of printed purchase order and acceptance (sometimes called "acknowledgment") forms. Because the forms are oriented to the thinking of the respective drafting parties, the terms contained in them often do not correspond. Often the seller's form contains terms different from or additional to those set forth in the buyer's form. Nevertheless, the parties proceed with the transaction.

2. Under this Article a proposed deal which in commercial understanding has in fact been closed is recognized as a contract. Therefore, any additional matter contained in the confirmation or in the acceptance falls within subsection (2) and must be regarded as a proposal for an added term unless the acceptance is made conditional on the acceptance of the additional or different terms.

3. Whether or not additional or different terms will become part of the agreement depends upon the provisions of subsection (2). If they are such as materially to alter the original bargain, they will not be included unless expressly agreed to by the other party. If, however, they are terms which would not so change the bargain they will be incorporated unless notice of objection to them has already been given or is given within a reasonable time.

4. Examples of typical clauses which would normally "materially alter" the contract and so result in surprise or hardship if incorporated without express awareness by the other party are: a clause negating such standard warranties as that of merchantability or fitness for a particular purpose in

circumstances in which either warranty normally attaches; a clause requiring a guaranty of 90% or 100% deliveries in a case such as a contract by cannery, where the usage of the trade allows greater quantity leeways; a clause reserving to the seller the power to cancel upon the buyer's failure to meet any invoice when due; a clause requiring that complaints be made in a time materially shorter than customary or reasonable.

5. Examples of clauses which involve no element of unreasonable surprise and which therefore are to be incorporated in the contract unless notice of objection is seasonably given are: a clause setting forth and perhaps enlarging slightly upon the seller's exemption due to supervening causes beyond his control, similar to those covered by the provision of this Article [Chapter] on merchant's excuse by failure of presupposed conditions or a clause fixing in advance any reasonable formula of proration under such circumstances; a clause fixing a reasonable time for complaints within customary limits, or in the case of a purchase for sub-sale, providing for inspection by the sub-purchaser; a clause providing for interest on overdue invoices or fixing the seller's standard credit terms where they are within the range of trade practice and do not limit any credit bargained for; a clause limiting the right of rejection for defects which fall within the customary trade tolerances for acceptance "with adjustment" or otherwise limiting remedy in a reasonable manner (see Sections 2-718 and 2-719).

6. If no answer is received within a reasonable time after additional terms are proposed, it is both fair and commercially sound to assume that their inclusion has been assented to. Where clauses on confirming forms sent by both parties conflict each party must be assumed to object to a clause of the other conflicting with one on the confirmation sent by himself. As a result the requirement that there be notice of objection which is found in subsection (2) is satisfied and the conflicting terms do not become a part of the contract. The contract then consists of the terms originally expressly agreed to, terms on which the confirmations agree, and terms supplied by this Act, including subsection (2). The written confirmation is also subject to Section 2-201. Under that section a failure to respond permits enforcement of a prior oral agreement; under this section a failure to respond permits additional terms to become part of the agreement.

7. In many cases, as where goods are shipped, accepted and paid for before any dispute arises, there is no question whether a contract has been

made. In such cases, where the writings of the parties do not establish a contract, it is not necessary to determine which act or document constituted the offer and which the acceptance. See Section 2-204. The only question is what terms are included in the contract, and subsection (3) furnishes the governing rule.

Cross References: See generally Section 2-302.

Point 5: Sections 2-513, 2-602, 2-607, 2-609, 2-612, 2-614, 2-615, 2-616, 2-718 and 2-719.

Point 6: Sections 1-102 and 2-104.

Definitional Cross References: "Between merchants." Section 2-104.

"Contract." Section 1-201.

"Notification." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Seasonably." Section 1-204 [1-205].

"Send." Section 1-201.

"Term." Section 1-201.

"Written." Section 1-201.

§ 28-2-208. Course of performance or practical construction. [Repealed.]

STATUTORY NOTES

Compiler's Notes.

This section, which comprised 1967, ch. 161, § 2-208, p. 351, was repealed by S.L. 2004, ch. 43, § 30.

§ 28-2-209. Modification, rescission and waiver. — (1) An agreement modifying a contract within this chapter needs no consideration to be binding.

(2) A signed agreement which excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded, but except as between merchants such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) The requirements of the statute of frauds section of this chapter (section 28-2-201[, Idaho Code]) must be satisfied if the contract as modified is within its provisions.

(4) Although an attempt at modification or rescission does not satisfy the requirements of subsection (2) or (3) it can operate as a waiver.

(5) A party who has made a waiver affecting an executory portion of the contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

History.

1967, ch. 161, § 2-209, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in subsection (3) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Unilateral modification ineffective.

Applicability.

Where sellers delivered equipment and vehicles to buyer, buyer accepted the goods, buyer paid the sum due, sellers accepted the payment, and sellers released their liens on the equipment, an oral modification of the original agreement was enforceable, even though the price was more than $500 (see § 28-2-201) because the agreement was fully executed. Apple's Mobile Catering, LLC v. O'Dell, 149 Idaho 211, 233 P.3d 142 (2010).

Receipt and Acceptance.

Receipt and acceptance of goods is deemed to constitute an unambiguous overt admission by both parties that a contract actually exists, and makes admissible oral evidence of other terms of the contract. Under the "receipt and acceptance" exception to the statute, a modified contract may be enforced to the extent of the goods that have been accepted; thus, whether the implied agreement between building contractor and building supplies company regarding conditions of payment is viewed as modifying the terms of the parties' initial contract, or as an agreement to terminate the initial contract and create a new, "original" contract, its enforcement is not barred by the statute of frauds. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Unilateral Modification Ineffective.

Although a modification of a contract under Article 2 of the Uniform Commercial Code needs no consideration to be binding, this section governing modifications contemplates an "agreement" modifying a contract. Thus, a seller's unilateral attempts at modification are ineffective because, in such cases, the buyer had "agreed" to nothing. Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995).

Cited Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Palmer v. Idaho Peterbilt, Inc., 102 Idaho 800, 641 P.2d 346 (Ct. App. 1982); Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983); Gebrueder Heidemann, K.G. v. A.M.R. Corp., 107 Idaho 275, 688 P.2d 1180 (1984); Breeden v. Edmenson, 107 Idaho 319, 689 P.2d 211 (Ct. App. 1984); Fernandez v. Western R.R. Bldrs., 112 Idaho 907, 736 P.2d 1361 (Ct. App. 1987).

RESEARCH REFERENCES

Am. Jur. 2d. — 17A Am. Jur. 2d, Contracts, § 500 et seq.

67 Am. Jur. 2d, Sales, § 328 et seq.

Official Comment

Prior Uniform Statutory Provision: Subsection (1) — Compare Section 1, Uniform Written Obligations Act; Subsections (2) to (5) — none.

Purposes of Changes and New Matter: 1. This section seeks to protect and make effective all necessary and desirable modifications of sales contracts without regard to the technicalities which at present hamper such adjustments.

2. Subsection (1) provides that an agreement modifying a sales contract needs no consideration to be binding.

However, modifications made thereunder must meet the test of good faith imposed by this Act. The effective use of bad faith to escape performance on the original contract terms is barred, and the extortion of a "modification" without legitimate commercial reason is ineffective as a violation of the duty of good faith. Nor can a mere technical consideration support a modification made in bad faith.

The test of "good faith" between merchants or as against merchants includes "observance of reasonable commercial standards of fair dealing in the trade" (Section 2-103), and may in some situations require an objectively demonstrable reason for seeking a modification. But such matters as a market shift which makes performance come to involve a loss may provide such a reason even though there is no such unforeseen difficulty as would make out a legal excuse from performance under Sections 2-615 and 2-616.

3. Subsections (2) and (3) are intended to protect against false allegations of oral modifications. "Modification or rescission" includes abandonment or other change by mutual consent, contrary to the decision in *Green v. Doniger*, 300 N.Y. 238, 90 N.E.2d 56 (1949); it does not include unilateral "termination" or "cancellation" as defined in Section 2-106.

The Statute of Frauds provisions of this Article [Chapter] are expressly applied to modifications by subsection (3). Under those provisions the "delivery and acceptance" test is limited to the goods which have been accepted, that is, to the past. "Modification" for the future cannot therefore be conjured up by oral testimony if the price involved is $500.00 or more since such modification must be shown at least by an authenticated memo. And since a memo is limited in its effect to the quantity of goods set forth in it there is safeguard against oral evidence.

Subsection (2) permits the parties in effect to make their own Statute of Frauds as regards any future modification of the contract by giving effect to a clause in a signed agreement which expressly requires any modification to be by signed writing. But note that if a consumer is to be held to such a clause on a form supplied by a merchant it must be separately signed.

4. Subsection (4) is intended, despite the provisions of subsections (2) and (3), to prevent contractual provisions excluding modification except by a signed writing from limiting in other respects the legal effect of the parties' actual later conduct. The effect of such conduct as a waiver is further regulated in subsection (5).

Cross References: Point 1: Section 1-203.

Point 2: Sections 1-201, 1-203, 2-615 and 2-616.

Point 3: Sections 2-106, 2-201 and 2-202.

Point 4: Sections 2-202 and 2-208.

Definitional Cross References: "Agreement." Section 1-201.

"Between merchants." Section 2-104.

"Contract." Section 1-201.

"Notification." Section 1-201.

"Signed." Section 1-201.

"Term." Section 1-201.

"Writing." Section 1-201.

§ 28-2-210. Delegation of performance — Assignment of rights. — (1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

(2) Except as otherwise provided in section 28-9-406[, Idaho Code], unless otherwise agreed, all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.

(3) The creation, attachment, perfection or enforcement of a security interest in the seller's interest under a contract is not a transfer that materially changes the duty of or increases materially the burden or risk imposed on the buyer or impairs materially the buyer's chance of obtaining return performance within the purview of subsection (2) of this section unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the seller. Even in that event, the creation, attachment, perfection and enforcement of the security interest remain effective, but: (i) the seller is liable to the buyer for damages caused by the delegation to the extent that the damages could not reasonably be prevented by the buyer; and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the contract for sale or an injunction against enforcement of the security interest or consummation of the enforcement.

(4) Unless the circumstances indicate the contrary, a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

(5) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of

rights and unless the language or the circumstances, as in an assignment for security, indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(6) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee (section 28-2-609[, Idaho Code]).

History.

1967, ch. 161, § 2-210, p. 351; am. 2001, ch. 208, § 6, p. 704.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (2) and (6) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

CASE NOTES

Cited Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

RESEARCH REFERENCES

ALR. — Anti-assignment clause in contract as precluding enforcement by undisclosed principal. 75 A.L.R.3d 1184.

Modern status and application of rule that only voluntary transfer or assignment of claim against United States is within Assignment of Claims Act (31 USCS § 203, 41 USCS § 15). 44 A.L.R. Fed. 775.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. Generally, this section recognizes both delegation of performance and assignability as normal and permissible incidents of a contract for the sale of goods.

2. Delegation of performance, either in conjunction with an assignment or otherwise, is provided for by subsection (1) where no substantial reason can be shown as to why the delegated performance will not be as satisfactory as personal performance.

3. Under subsection (2) rights which are no longer executory such as a right to damages for breach or a right to payment of an "account" as defined in the Article [Chapter] on Secured Transactions (Article [Chapter] 9) may be assigned although the agreement prohibits assignment. In such cases no question of delegation of any performance is involved. The assignment of a "contract right" as defined in the Article [Chapter] on Secured Transactions (Article [Chapter] 9) is not covered by this subsection.

4. The nature of the contract or the circumstances of the case, however, may bar assignment of the contract even where delegation of performance is not involved. This Article [Chapter] and this section are intended to clarify this problem, particularly in cases dealing with output requirement and exclusive dealing contracts. In the first place the section on requirements and exclusive dealing removes from the construction of the original contract most of the "personal discretion" element by substituting the reasonably objective standard of good faith operation of the plant or business to be supplied. Secondly, the section on insecurity and assurances, which is specifically referred to in subsection (5) of this section, frees the other party from the doubts and uncertainty which may afflict him under an assignment of the character in question by permitting him to demand adequate assurance of due performance without which he may suspend his own performance. Subsection (5) is not in any way intended to limit the effect of the section on insecurity and assurances and the word "performance" includes the giving of orders under a requirements contract. Of course, in any case where a material personal discretion is sought to be transferred, effective assignment is barred by subsection (2).

5. Subsection (4) lays down a general rule of construction distinguishing between a normal commercial assignment, which substitutes the assignee for the assignor both as to rights and duties, and a financing assignment in which only the assignor's rights are transferred.

This Article [Chapter] takes no position on the possibility of extending some recognition or power to the original parties to work out normal commercial readjustments of the contract in the case of financing assignments even after the original obligor has been notified of the assignment. This question is dealt with in the Article [Chapter] on Secured Transactions (Article [Chapter] 9).

6. Subsection (5) recognizes that the non-assigning original party has a stake in the reliability of the person with whom he has closed the original contract, and is, therefore, entitled to due assurance that any delegated performance will be properly forthcoming.

7. This section is not intended as a complete statement of the law of delegation and assignment but is limited to clarifying a few points doubtful under the case law. Particularly, neither this section nor this Article [Chapter] touches directly on such questions as the need or effect of notice of the assignment, the rights of successive assignees, or any question of the form of an assignment, either as between the parties or as against any third parties. Some of these questions are dealt with in Article [Chapter] 9.

Cross References: Point 3: Articles [Chapters] 5 and 9.

Point 4: Sections 2-306 and 2-609.

Point 5: Article [Chapter] 9, Sections 9-317 and 9-318.

Point 7: Article [Chapter] 9.

Definitional Cross References: "Agreement." Section 1-201.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Party." Section 1-201.

"Rights." Section 1-201.

"Seller." Section 2-103.

"Term." Section 1-201.

Part 3
General Obligation and Construction of Contract

• Title 28 •, « Ch. 2 », « Pt. 3 », • § 28-2-301 »

§ 28-2-301. General obligations of parties. — The obligation of the seller is to transfer and deliver and that of the buyer is to accept and pay in accordance with the contract.

History.

1967, ch. 161, § 2-301, p. 351.

CASE NOTES

Cited Building Concepts, Ltd. v. Pickering, 114 Idaho 640, 759 P.2d 931 (Ct. App. 1988).

Decisions Under Prior Law

Forfeiture of Lease.

In determining whether a sale of personalty by an Idaho mining lessee to the lessor failed to vest title on the ground that no delivery was made, upon forfeiture of the lease, it was the duty of the lessee to deliver the property, and the duty of the lessor to accept it. Walker v. Lightfoot, 124 F.2d 3 (9th Cir. 1941).

Inspection.

Conceding that the buyer should examine goods and notify of rejection and rescission, because of breach of warranty, as soon as possible, the question of what was reasonable as to time and place was a jury question. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Inspection was to be made at the destination, and a reasonable time therefor was allowed. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Requisite Quality.

If the contract for sale of peaches was for U.S. No. 1's, buyer was required to accept only peaches of such grade. Peck v. Nixon, 47 Idaho 675, 277 P. 1112 (1929); Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

What Constitutes Acceptance.

Where buyer sold part of goods delivered in its usual course of business, there was acceptance of entire consignment, notwithstanding attempt to return balance. Gross Mfg. Co. v. Redfield, 48 Idaho 399, 282 P. 487 (1929); Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

RESEARCH REFERENCES

Am. Jur. 2d. — 17A Am. Jur. 2d, Contracts, § 328 et seq.

C.J.S. — 77A C.J.S., Sales, § 421 et seq.

Official Comment

Prior Uniform Statutory Provision: Sections 11 and 41, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: This section uses the term "obligation" in contrast to the term "duty" in order to provide for the "condition" aspects of delivery and payment insofar as they are not modified by other sections of this Article [Chapter] such as those on cure of tender. It thus replaces not only the general provisions of the Uniform Sales Act on the parties' duties, but also the general provisions of that Act on the effect of conditions. In order to determine what is "in accordance with the contract" under this Article [Chapter] usage of trade, course of dealing and performance, and the general background of circumstances must be given due consideration in

conjunction with the lay meaning of the words used to define the scope of the conditions and duties.

Cross References: Section 1-106. See also Sections 1-205 [1-303], 2-208, 2-209, 2-508 and 2-612.

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Party." Section 1-201.

"Seller." Section 2-103.

§ 28-2-302. Unconscionable contract or clause. — (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

History.

1967, ch. 161, § 2-302, p. 351.

CASE NOTES

Applicability.

This section does not apply to the public utilities commission, because the commission is not a court. McNeal v. Idaho PUC, 142 Idaho 685, 132 P.3d 442 (2006), overruled on other grounds, Verska v. St. Alphonsus Med. Ctr., 151 Idaho 889, 265 P.3d 502 (2011).

Failure to Respond.

In a suit to recover a deficiency after repossession and sale of certain equipment, the failure of a guarantor to respond to a request for an admission that the equipment had been disposed of and that proper credits had been applied to the debtor’s account disposed of any claim by the

guarantor that the losses had not properly mitigated, but not the claim that the lease was unconscionable. M & H Rentals, Inc. v. Sales, 108 Idaho 567, 700 P.2d 970 (Ct. App. 1985).

Fraud.

Jury's rejection of fraud claims did not preclude a finding that manufacturer had superior knowledge. The determination on unconscionability is made by the trial court, not the jury, and that determination is made by the trial court's assessments of the facts prior to the jury's consideration of the case. Therefore, jury's fraud verdict did not affect trial court's unconscionability ruling. Walker v. American Cyanamid Co., 130 Idaho 824, 948 P.2d 1123 (1997).

Procedural Unconscionability.

Where manufacturer had superior knowledge concerning herbicide and made representations concerning its safety, liability limitation label was ambiguous, and farm lacked bargaining power to negotiate concerning the limitation, the limitation of liability provision was procedurally unconscionable. Walker v. American Cyanamid Co., 130 Idaho 824, 948 P.2d 1123 (1997).

Substantive Unconscionability.

Substantive unconscionability asks whether, at the time the contract was executed, and in light of the general background and commercial needs of a particular case, the clause is so one-sided as to oppress or unfairly surprise one of the parties. In the instant case, unfair surprise existed because of the ambiguity of the limitation of liability provision and supported finding of substantive unconscionability. Walker v. American Cyanamid Co., 130 Idaho 824, 948 P.2d 1123 (1997).

Cited Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Brooks v. Terteling, 107 Idaho 262, 688 P.2d 1167 (1984); Adkison Corp. v. American Bldg. Co., 107 Idaho 406, 690 P.2d 341 (1984); First Sec. Bank v. Mountain View Equip. Co., 112 Idaho 158, 730 P.2d 1078 (Ct. App. 1986).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 210 et seq.

ALR. — "Unconscionability" as ground for refusing enforcement of contract for sale or goods or agreement collateral thereto. 18 A.L.R.3d 1305.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past such policing has been accomplished by adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability. The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. Subsection (2) makes it clear that it is proper for the court to hear evidence upon these questions. The principle is one of the prevention of oppression and unfair surprise (Cf. *Campbell Soup Co. v. Wentz*, 172 F.2d 80, 3d Cir. 1948) and not of disturbance of allocation of risks because of superior bargaining power. The underlying basis of this section is illustrated by the results in cases such as the following: *Kansas City Wholesale Grocery Co. v. Weber Packing Corporation*, 93 Utah 414, 73 P.2d 1272 (1937), where a clause limiting time for complaints was held inapplicable to latent defects in a shipment of catsup which could be discovered only by microscopic analysis; *Hardy v. General Motors Acceptance Corporation*, 38 Ga. App. 463, 144 S.E. 327 (1928), holding that a disclaimer of warranty clause applied only to express warranties, thus letting in a fair implied warranty; *Andrews Bros. v. Singer & Co.* (1934 CA) 1 K.B. 17, holding that where a car with substantial mileage was delivered instead of a "new" car, a disclaimer of warranties, including those "implied," left unaffected an "express obligation" on the description, even though the Sale of Goods Act

called such an implied warranty; *New Prague Flouring Mill Co. v. G. A. Spears*, 194 Iowa 417, 189 N.W. 815 (1922), holding that a clause permitting the seller, upon the buyer's failure to supply shipping instructions, to cancel, ship, or allow delivery date to be indefinitely postponed 30 days at a time by the inaction, does not indefinitely postpone the date of measuring damages for the buyer's breach, to the seller's advantage; and *Kansas Flour Mills Co. v. Dirks*, 100 Kan. 376, 164 P. 273 (1917), where under a similar clause in a rising market the court permitted the buyer to measure his damages for non-delivery at the end of only one 30 day postponement; *Green v. Arcos, Ltd.* (1931 CA) 47 T.L.R. 336, where a blanket clause prohibiting rejection of shipments by the buyer was restricted to apply to shipments where discrepancies represented merely mercantile variations; *Meyer v. Packard Cleveland Motor Co.*, 106 Ohio St. 328, 140 N.E. 118 (1922), in which the court held that a "waiver" of all agreements not specified did not preclude implied warranty of fitness of a rebuilt dump truck for ordinary use as a dump truck; *Austin Co. v. J. H. Tillman Co.*, 104 Or. 541, 209 P. 131 (1922), where a clause limiting the buyer's remedy to return was held to be applicable only if the seller had delivered a machine needed for a construction job which reasonably met the contract description; *Bekkevold v. Potts*, 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164 (1927), refusing to allow warranty of fitness for purpose imposed by law to be negated by clause excluding all warranties "made" by the seller; *Robert A. Munroe & Co. v. Meyer* (1930) 2 K.B. 312, holding that the warranty of description overrides a clause reading "with all faults and defects" where adulterated meat not up to the contract description was delivered.

2. Under this section the court, in its discretion, may refuse to enforce the contract as a whole if it is permeated by the unconscionability, or it may strike any single clause or group of clauses which are so tainted or which are contrary to the essential purpose of the agreement, or it may simply limit unconscionable clauses so as to avoid unconscionable results.

3. The present section is addressed to the court, and the decision is to be made by it. The commercial evidence referred to in subsection (2) is for the court's consideration, not the jury's. Only the agreement which results from the court's action on these matters is to be submitted to the general triers of the facts.

Definitional Cross Reference: "Contract." Section 1-201.

§ 28-2-303. Allocation or division of risks. — Where this chapter allocates a risk or a burden as between the parties "unless otherwise agreed," the agreement may not only shift the allocation but may also divide the risk or burden.

History.

1967, ch. 161, § 2-303, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 378 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. This section is intended to make it clear that the parties may modify or allocate "unless otherwise agreed" risks or burdens imposed by this Article [Chapter] as they desire, always subject, of course, to the provisions on unconscionability.

Compare Section 1-102 (4).

2. The risk or burden may be divided by the express terms of the agreement or by the attending circumstances, since under the definition of "agreement" in this Act the circumstances surrounding the transaction as well as the express language used by the parties enter into the meaning and substance of the agreement.

Cross References: Point 1: Sections 1-102, 2-302.

Point 2: Section 1-201.

Definitional Cross References: "Party." Section 1-201.

"Agreement." Section 1-201.

§ 28-2-304. Price payable in money, goods, realty, or otherwise. — (1) The price can be made payable in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer.

(2) Even though all or part of the price is payable in an interest in realty the transfer of the goods and the seller's obligations with reference to them are subject to this chapter, but not the transfer of the interest in realty or the transferor's obligations in connection therewith.

History.

1967, ch. 161, § 2-304, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 60 et seq.

67 Am. Jur. 2d, Sales, § 193 et seq.

Official Comment

Prior Uniform Statutory Provision: Subsections (2) and (3) of Section 9, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: 1. This section corrects the phrasing of the Uniform Sales Act so as to avoid misconstruction and produce greater accuracy in commercial result. While it continues the essential intent and purpose of the Uniform Sales Act it rejects any purely verbalistic construction in disregard of the underlying reason of the provisions.

2. Under subsection (1) the provisions of this Article [Chapter] are applicable to transactions where the "price" of goods is payable in something other than money. This does not mean, however, that this whole Article [Chapter] applies automatically and in its entirety simply because an agreed transfer of title to goods is not a gift. The basic purposes and reasons

of the Article [Chapter] must always be considered in determining the applicability of any of its provisions.

3. Subsection (2) lays down the general principle that when goods are to be exchanged for realty, the provisions of this Article [Chapter] apply only to those aspects of the transaction which concern the transfer of title to goods but do not affect the transfer of the realty since the detailed regulation of various particular contracts which fall outside the scope of this Article [Chapter] is left to the courts and other legislation. However, the complexities of these situations may be such that each must be analyzed in the light of the underlying reasons in order to determine the applicable principles. Local statutes dealing with realty are not to be lightly disregarded or altered by language of this Article [Chapter]. In contrast, this Article [Chapter] declares definite policies in regard to certain matters legitimately within its scope though concerned with real property situations, and in those instances the provisions of this Article [Chapter] control.

Cross References: Point 1: Section 1-102.

Point 3: Sections 1-102, 1-103, 1-104 and 2-107.

Definitional Cross References: "Goods." Section 2-105.

"Money." Section 1-201.

"Party." Section 1-201.

"Seller." Section 2-103.

§ 28-2-305. Open price term. — (1) The parties if they so intend can conclude a contract for sale even though the price is not settled. In such a case the price is a reasonable price at the time for delivery if

(a) nothing is said as to price; or

(b) the price is left to be agreed by the parties and they fail to agree; or
(c) the price is to be fixed in terms of some agreed market or other standard as set or recorded by a third person or agency and it is not so set or recorded.

(2) A price to be fixed by the seller or by the buyer means a price for him to fix in good faith.

(3) When a price left to be fixed otherwise than by agreement of the parties fails to be fixed through fault of one party the other may at his option treat the contract as cancelled or himself fix a reasonable price.

(4) Where, however, the parties intend not to be bound unless the price be fixed or agreed and it is not fixed or agreed there is no contract. In such a case the buyer must return any goods already received or if unable so to do must pay their reasonable value at the time of delivery and the seller must return any portion of the price paid on account.

History.

1967, ch. 161, § 2-305, p. 351.

CASE NOTES

Application.

The "reasonable price" standard of this section is applicable only where the price is not settled by the parties. Palmer v. Idaho Peterbilt, Inc., 102 Idaho 800, 641 P.2d 346 (Ct. App. 1982).

Failure to Agree On Reasonable Price.

Where parties contracted for sale of wheat and left a factor in the price open to be agreed upon at a later date, the fact that this term was left open to be established by the parties at a later date and that the parties failed to reach agreement on the figure did not make the contract ambiguous or void for indefiniteness but simply meant that a reasonable figure remained to be determined; therefore, when the defendant sold the wheat to third party, he breached the contract. D.R. Curtis Co. v. Mathews, 103 Idaho 776, 653 P.2d 1188 (Ct. App. 1982).

Where the parties agreed to enter a contract the agreement did not fail for indefiniteness simply because they failed to agree upon a price. Licklyey v. Max Herbold, Inc., 133 Idaho 209, 984 P.2d 697 (1999).

Where a potato farmer delivered potatoes to a processor and also sold potatoes from the same field on the open market for a certain price, the trial court did not err in finding that that price was a reasonable one under a contract which had not set a figure. Licklyey v. Max Herbold, Inc., 133 Idaho 209, 984 P.2d 697 (1999).

Good Faith.

It appears that the provisions for "good faith" in this section do not make it "applicable" to the terms of a purported agreement whereby buyer was free to buy from others if seller would not match their prices, while seller was bound to fill buyer's requirements whenever buyer so demanded. Harvey v. Fearless Farris Whsle., Inc., 589 F.2d 451 (9th Cir. 1979).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 193 et seq.

ALR. — Construction and application of UCC § 2-305 dealing with open price term contracts. 91 A.L.R.3d 1237.

Official Comment

Prior Uniform Statutory Provision: Sections 9 and 10, Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: 1. This section applies when the price term is left open on the making of an agreement which is nevertheless intended by the parties to be a binding agreement. This Article [Chapter] rejects in these instances the formula that "an agreement to agree is unenforceable" if the case falls within subsection (1) of this section, and rejects also defeating such agreements on the ground of "indefiniteness." Instead this Article [Chapter] recognizes the dominant intention of the parties to have the deal continue to be binding upon both. As to future performance, since this Article [Chapter] recognizes remedies such as cover (Section 2-712), resale (Section 2-706) and specific performance (Section 2-716) which go beyond any mere arithmetic as between contract price and market price, there is usually a "reasonably certain basis for granting an appropriate remedy for breach" so that the contract need not fail for indefiniteness.

2. Under some circumstances the postponement of agreement on price will mean that no deal has really been concluded, and this is made express in the preamble of subsection (1) ("The parties if they so intend") and in subsection (4). Whether or not this is so is, in most cases, a question to be determined by the trier of fact.

3. Subsection (2), dealing with the situation where the price is to be fixed by one party rejects the uncommercial idea that an agreement that the seller may fix the price means that he may fix any price he may wish by the express qualification that the price so fixed must be fixed in good faith. Good faith includes observance of reasonable commercial standards of fair dealing in the trade if the party is a merchant. (Section 2-103). But in the normal case a "posted price" or a future seller's or buyer's "given price," "price in effect," "market price," or the like satisfies the good faith requirement.

4. The section recognizes that there may be cases in which a particular person's judgment is not chosen merely as a barometer or index of a fair price but is an essential condition to the parties' intent to make any contract at all. For example, the case where a known and trusted expert is to "value" a particular painting for which there is no market standard differs sharply from the situation where a named expert is to determine the grade of cotton, and the difference would support a finding that in the one the parties did not intend to make a binding agreement if that expert were unavailable whereas

in the other they did so intend. Other circumstances would of course affect the validity of such a finding.

5. Under subsection (3), wrongful interference by one party with any agreed machinery for price fixing in the contract may be treated by the other party as a repudiation justifying cancellation, or merely as a failure to take cooperative action thus shifting to the aggrieved party the reasonable leeway in fixing the price.

6. Throughout the entire section, the purpose is to give effect to the agreement which has been made. That effect, however, is always conditioned by the requirement of good faith action which is made an inherent part of all contracts within this Act. (Section 1-203).

Cross References: Point 1: Sections 2-204(3), 2-706, 2-712 and 2-716.

Point 3: Section 2-103.

Point 5: Sections 2-311 and 2-610.

Point 6: Section 1-203.

Definitional Cross References: "Agreement." Section 1-201.

"Burden of establishing." Section 1-201.

"Buyer." Section 2-103.

"Cancellation." Section 2-106.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Fault." Section 1-201.

"Goods." Section 2-105.

"Party." Section 1-201.

"Receipt of goods." Section 2-103.

"Seller." Section 2-103.

"Term." Section 1-201.

§ 28-2-306. Output, requirements and exclusive dealings. — (1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded.

(2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

History.

1967, ch. 161, § 2-306, p. 351.

CASE NOTES

Damages.

While damages might have been difficult to determine it was clear that the breach of an output contract by a trout hatchery had deprived a trout grower of the opportunity to complete performance of the contract for the remaining two years and that losses for those years had occurred; thus, the trial court erred in not awarding damages for years 6 and 7 and the issue was remanded. Griffith v. Clear Lakes Trout Co., 143 Idaho 733, 152 P.3d 604 (2007).

Requirements Contract.

A purported agreement which allows buyer to purchase an indefinite proportion of its supplies from sellers other than defendant when it is to its advantage to do so, but allegedly binds defendant to supply buyer with all buyer's needs at buyer's request, is not a requirement's contract within this

section. Harvey v. Fearless Farris Whsle., Inc., 589 F.2d 451 (9th Cir. 1979).

Defendant admitted while testifying as an adverse party in plaintiff's case-in-chief, that defendant and plaintiff had entered into an agreement wherein defendant agreed to use plaintiff's potatoes to help fulfill a potato contract with a third party; therefore, there was substantial evidence that defendant and plaintiff had entered into an enforceable requirements contract. Mitchell v. Barendregt, 120 Idaho 837, 820 P.2d 707 (Ct. App. 1991).

In a breach of a contract action, as the quantity of fish under the agreement was not only subject to the trout farmers' good faith output of market size trout, but also subject to the fish hatchery's good faith requirements for trout in its resale market, the parties entered into an output/requirements contract under this section. Griffith v. Clear Lakes Trout Co., 146 Idaho 613, 200 P.3d 1162 (2009).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 222 et seq.

ALR. — Establishment and construction of requirements contracts under § 2-306(1) of Uniform Commercial Code. 94 A.L.R.5th 247.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) of this section, in regard to output and requirements, applies to this specific problem the general approach of this Act which requires the reading of commercial background and intent into the language of any agreement and demands good faith in the performance of that agreement. It applies to such contracts of nonproducing establishments such as dealers or distributors as well as to manufacturing concerns.

2. Under this Article [Chapter], a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party. Nor does such a contract lack mutuality

of obligation since, under this section, the party who will determine quantity is required to operate his plant or conduct his business in good faith and according to commercial standards of fair dealing in the trade so that his output or requirements will approximate a reasonably foreseeable figure. Reasonable elasticity in the requirements is expressly envisaged by this section and good faith variations from prior requirements are permitted even when the variation may be such as to result in discontinuance. A shutdown by a requirements buyer for lack of orders might be permissible when a shutdown merely to curtail losses would not. The essential test is whether the party is acting in good faith. Similarly, a sudden expansion of the plant by which requirements are to be measured would not be included within the scope of the contract as made but normal expansion undertaken in good faith would be within the scope of this section. One of the factors in an expansion situation would be whether the market price had risen greatly in a case in which the requirements contract contained a fixed price. Reasonable variation of an extreme sort is exemplified in *Southwest Natural Gas Co. v. Oklahoma Portland Cement Co.*, 102 F.2d 630 (C.C.A. 10, 1939). This Article [Chapter] takes no position as to whether a requirements contract is a provable claim in bankruptcy.

3. If an estimate of output or requirements is included in the agreement, no quantity unreasonably disproportionate to it may be tendered or demanded. Any minimum or maximum set by the agreement shows a clear limit on the intended elasticity. In similar fashion, the agreed estimate is to be regarded as a center around which the parties intend the variation to occur.

4. When an enterprise is sold, the question may arise whether the buyer is bound by an existing output or requirements contract. That question is outside the scope of this Article [Chapter], and is to be determined on other principles of law. Assuming that the contract continues, the output or requirements in the hands of the new owner continue to be measured by the actual good faith output or requirements under the normal operation of the enterprise prior to sale. The sale itself is not grounds for sudden expansion or decrease.

5. Subsection (2), on exclusive dealing, makes explicit the commercial rule embodied in this Act under which the parties to such contracts are held to have impliedly, even when not expressly, bound themselves to use

reasonable diligence as well as good faith in their performance of the contract. Under such contracts the exclusive agent is required, although no express commitment has been made, to use reasonable effort and due diligence in the expansion of the market or the promotion of the product, as the case may be. The principal is expected under such a contract to refrain from supplying any other dealer or agent within the exclusive territory. An exclusive dealing agreement brings into play all of the good faith aspects of the output and requirement problems of subsection (1). It also raises questions of insecurity and right to adequate assurance under this Article [Chapter].

Cross References: Point 4: Section 2-210.

Point 5: Sections 1-203 and 2-609.

Definitional Cross References: "Agreement." Section 1-201.

"Buyer." Section 2-103.

"Contract for sale." Section 2-106.

"Good faith." Section 1-201.

"Goods." Section 2-105.

"Party." Section 1-201.

"Term." Section 1-201.

"Seller." Section 2-103.

§ 28-2-307. Delivery in single lot or several lots. — Unless otherwise agreed all goods called for by a contract for sale must be tendered in a single delivery and payment is due only on such tender but where the circumstances give either party the right to make or demand delivery in lots the price if it can be apportioned may be demanded for each lot.

History.

1967, ch. 161, § 2-307, p. 351.

Official Comment

Prior Uniform Statutory Provision: Section 45(1), Uniform Sales Act.

Changes: Rewritten and expanded.

Purposes of Changes: 1. This section applies where the parties have not specifically agreed whether delivery and payment are to be by lots and generally continues the essential intent of original Act, Section 45(1) by assuming that the parties intended delivery to be in a single lot.

2. Where the actual agreement or the circumstances do not indicate otherwise, delivery in lots is not permitted under this section and the buyer is properly entitled to reject for a deficiency in the tender, subject to any privilege in the seller to cure the tender.

3. The "but" clause of this section goes to the case in which it is not commercially feasible to deliver or to receive the goods in a single lot as for example, where a contract calls for the shipment of ten carloads of coal and only three cars are available at a given time. Similarly, in a contract involving brick necessary to build a building the buyer's storage space may be limited so that it would be impossible to receive the entire amount of brick at once, or it may be necessary to assemble the goods as in the case of cattle on the range, or to mine them.

In such cases, a partial delivery is not subject to rejection for the defect in quantity alone, if the circumstances do not indicate a repudiation or default by the seller as to the expected balance or do not give the buyer ground for suspending his performance because of insecurity under the provisions of

Section 2-609. However, in such cases the undelivered balance of goods under the contract must be forthcoming within a reasonable time and in a reasonable manner according to the policy of Section 2-503 on manner of tender of delivery. This is reinforced by the express provisions of Section 2-608 that if a lot has been accepted on the reasonable assumption that its nonconformity will be cured, the acceptance may be revoked if the cure does not seasonably occur. The section rejects the rule of *Kelly Construction Co. v. Hackensack Brick Co.*, 91 N.J.L. 585, 103 A. 417, 2 A.L.R. 685 (1918) and approves the result in *Lynn M. Ranger, Inc. v. Gildersleeve*, 106 Conn. 372, 138 A. 142 (1927) in which a contract was made for six carloads of coal then rolling from the mines and consigned to the seller but the seller agreed to divert the carloads to the buyer as soon as the car numbers became known to him. He arranged a diversion of two cars and then notified the buyer who then repudiated the contract. The seller was held to be entitled to his full remedy for the two cars diverted because simultaneous delivery of all of the cars was not contemplated by either party.

4. Where the circumstances indicate that a party has a right to delivery in lots, the price may be demanded for each lot if it is apportionable.

Cross References: Point 1: Section 1-201.

Point 2: Sections 2-508 and 2-601.

Point 3: Sections 2-503, 2-608 and 2-609.

Definitional Cross References: “Contract for sale.” Section 2-106.

“Goods.” Section 2-105.

“Lot.” Section 2-105.

“Party.” Section 1-201.

“Rights.” Section 1-201.

§ 28-2-308. Absence of specified place for delivery. — Unless otherwise agreed

(a) the place for delivery of goods is the seller's place of business or if he has none his residence; but (b) in a contract for sale of identified goods which to the knowledge of the parties at the time of contracting are in some other place, that place is the place for their delivery; and (c) documents of title may be delivered through customary banking channels.

History.

1967, ch. 161, § 2-308, p. 351.

CASE NOTES

Shipment Contract.

Where the parties had not previously agreed to a delivery term, the contract was a "shipment" contract rather than a "destination" contract. In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

Decisions Under Prior Law

Condonation.

Receipt of the shipment of goods by the respondent, opening the package and retaining a portion thereof constituted a binding acceptance of the whole and condoned the lateness of the shipment. Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

Extension of Time for Delivery.

The parties may, by agreement, express or implied, extend the time for delivery, and where the seller agreed to manufacture articles according to specifications and deliver them within a certain time, and at the request of buyer agreed to changes in the specifications, this request implied a

reasonable extension of time made necessary by the changes. Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

Waiver of Time for Delivery.

The acceptance of the goods by the buyer after the time for delivery was a waiver of the seller's failure to deliver in the required time, insofar as the seller's right to recover the purchase price is concerned. Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 489 et seq.

Official Comment

Prior Uniform Statutory Provision: Paragraphs (a) and (b)—Section 43(1), Uniform Sales Act; Paragraph (c)—none.

Changes: Slight modification in language.

Purposes of Changes and New Matter: 1. Paragraphs (a) and (b) provide for those noncommercial sales and for those occasional commercial sales where no place or means of delivery has been agreed upon by the parties. Where delivery by carrier is "required or authorized by the agreement," the seller's duties as to delivery of the goods are governed not by this section but by Section 2-504.

2. Under paragraph (b) when the identified goods contracted for are known to both parties to be in some location other than the seller's place of business or residence, the parties are presumed to have intended that place to be the place of delivery. This paragraph also applies (unless, as would be normal, the circumstances show that delivery by way of documents is intended) to a bulk of goods in the possession of a bailee. In such a case, however, the seller has the additional obligation to procure the acknowledgment by the bailee of the buyer's right to possession.

3. Where "customary banking channels" call only for due notification by the banker that the documents are available, leaving the buyer himself to see to the physical receipt of the goods, tender at the buyer's address is not required under paragraph (c). But that paragraph merely eliminates the

possibility of a default by the seller if "customary banking channels" have been properly used in giving notice to the buyer. Where the bank has purchased a draft accompanied by or associated with documents or has undertaken its collection on behalf of the seller, Part 5 of Article [Chapter] 4 spells out its duties and relations to its customer. Where the documents move forward under a letter of credit the Article [Chapter] on Letters of Credit spells out the duties and relations between the bank, the seller and the buyer. Delivery in relationship to either tangible or electronic documents of title is defined in Article 1, Section 1-201.

4. The rules of this section apply only "unless otherwise agreed." The surrounding circumstances, usage of trade, course of dealing and course of performance, as well as the express language of the parties, may constitute an "otherwise agreement."

Cross References: Point 1: Sections 2-504 and 2-505.

Point 2: Section 2-503.

Point 3: Section 2-512, Article [Chapter] 4, Part 4 and Article [Chapter] 5.

Definitional Cross References: "Contract for sale." Section 2-106.

"Delivery." Section 1-201.

"Document of title." Section 1-201.

"Goods." Section 2-105.

"Party." Section 1-201.

"Seller." Section 2-103.

§ 28-2-309. Absence of specific time provisions — Notice of termination.

— (1) The time for shipment or delivery or any other action under a contract if not provided in this chapter or agreed upon shall be a reasonable time.

(2) Where the contract provides for successive performances but is indefinite in duration it is valid for a reasonable time but unless otherwise agreed may be terminated at any time by either party.

(3) Termination of a contract by one party except on the happening of an agreed event requires that reasonable notification be received by the other party and an agreement dispensing with notification is invalid if its operation would be unconscionable.

History.

1967, ch. 161, § 2-309, p. 351.

CASE NOTES

In General.

Since the "New Equipment Warranty" did not state the time for performance of the repair or replacement obligation, the defendants were obligated to repair or replace defective parts within a reasonable time pursuant to subsection (1) of this section. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Reasonableness.

Where an acceptance of an offer for the sale of steel pipe stated a delivery date two months later than that proposed by the offer, such date was reasonable in light of the distance which the pipe had to be transported and the seller breached the contract when it declined to complete deliveries before that date. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply,

Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

It could not be said that defendant, a manufacturer of recreational homes, provided reasonable notification of an impending termination of a contract with plaintiff, a dealer of manufactured homes, as a matter of law. Jen-Rath Co. v. KIT Mfg. Co., 137 Idaho 330, 48 P.3d 659 (2002).

After a buyer and seller entered into a contract for the sale of logs for the construction of a log cabin, and the contract failed to set forth a delivery date, the buyer waited for delivery of a complete log cabin package for over a year after paying the seller 70 percent of the contract price. The buyer then arranged to purchase the balance of logs needed to complete her cabin from another supplier, and the seller was found to have breached the contract by failing to deliver the logs within a reasonable time. Borah v. McCandless, 147 Idaho 73, 205 P.3d 1209 (2009).

Test of Reasonability.

In determining the issue of reasonability, factors such as the nature of the goods to be delivered, the extent of the seller's knowledge of the buyer's intentions, transportation conditions and the nature of the market should be considered. Anderson & Nafziger v. G.T. Newcomb, Inc., 100 Idaho 175, 595 P.2d 709 (1979).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 122 et seq.

Official Comment

Prior Uniform Statutory Provision: Subsection (1) — see Sections 43(2), 45(2), 47(1) and 48, Uniform Sales Act, for policy continued under this Article [Chapter]; Subsection (2) — none; Subsection (3) — none.

Changes: Completely different in scope.

Purposes of Changes and New Matter: 1. Subsection (1) requires that all actions taken under a sales contract must be taken within a reasonable time where no time has been agreed upon. The reasonable time under this provision turns on the criteria as to "reasonable time" and on good faith and

commercial standards set forth in Sections 1-203, 1-204 [1-205] and 2-103. It thus depends upon what constitutes acceptable commercial conduct in view of the nature, purpose and circumstances of the action to be taken. Agreement as to a definite time, however, may be found in a term implied from the contractual circumstances, usage of trade or course of dealing or performance as well as in an express term. Such cases fall outside of this subsection since in them the time for action is “agreed” by usage.

2. The time for payment, where not agreed upon, is related to the time for delivery; the particular problems which arise in connection with determining the appropriate time of payment and the time for any inspection before payment which is both allowed by law and demanded by the buyer are covered in Section 2-513.

3. The facts in regard to shipment and delivery differ so widely as to make detailed provision for them in the text of this Article [Chapter] impracticable. The applicable principles, however, make it clear that surprise is to be avoided, good faith judgment is to be protected, and notice or negotiation to reduce the uncertainty to certainty is to be favored.

4. When the time for delivery is left open, unreasonably early offers of or demands for delivery are intended to be read under this Article [Chapter] as expressions of desire or intention, requesting the assent or acquiescence of the other party, not as final positions which may amount without more to breach or to create breach by the other side. See Sections 2-207 and 2-609.

5. The obligation of good faith under this Act requires reasonable notification before a contract may be treated as breached because a reasonable time for delivery or demand has expired. This operates both in the case of a contract originally indefinite as to time and of one subsequently made indefinite by waiver.

When both parties let an originally reasonable time go by in silence, the course of conduct under the contract may be viewed as enlarging the reasonable time for tender or demand of performance. The contract may be terminated by abandonment.

6. Parties to a contract are not required in giving reasonable notification to fix, at peril of breach, a time which is in fact reasonable in the unforeseeable judgment of a later trier of fact. Effective communication of a

proposed time limit calls for a response, so that failure to reply will make out acquiescence. Where objection is made, however, or if the demand is merely for information as to when goods will be delivered or will be ordered out, demand for assurances on the ground of insecurity may be made under this Article [Chapter] pending further negotiations. Only when a party insists on undue delay or on rejection of the other party's reasonable proposal is there a question of flat breach under the present section.

7. Subsection (2) applies a commercially reasonable view to resolve the conflict which has arisen in the cases as to contracts of indefinite duration. The "reasonable time" of duration appropriate to a given arrangement is limited by the circumstances. When the arrangement has been carried on by the parties over the years, the "reasonable time" can continue indefinitely and the contract will not terminate until notice.

8. Subsection (3) recognizes that the application of principles of good faith and sound commercial practice normally call for such notification of the termination of a going contract relationship as will give the other party reasonable time to seek a substitute arrangement. An agreement dispensing with notification or limiting the time for the seeking of a substitute arrangement is, of course, valid under this subsection unless the results of putting it into operation would be the creation of an unconscionable state of affairs.

9. Justifiable cancellation for breach is a remedy for breach and is not the kind of termination covered by the present subsection.

10. The requirement of notification is dispensed with where the contract provides for termination on the happening of an "agreed event." "Event" is a term chosen here to contrast with "option" or the like.

Cross References: Point 1: Sections 1-203, 1-204 [1-205] and 2-103.

Point 2: Sections 2-320, 2-321, 2-504, and 2-511 through 2-514.

Point 5: Section 1-203.

Point 6: Section 2-609.

Point 7: Section 2-204.

Point 9: Sections 2-106, 2-318, 2-610 and 2-703.

Definitional Cross References: “Agreement.” Section 1-201.

“Contract.” Section 1-201.

“Notification.” Section 1-201.

“Party.” Section 1-201.

“Reasonable time.” Section 1-204 [1-205].

“Termination.” Section 2-106.

§ 28-2-310. Open time for payment or running of credit — Authority to ship under reservation. — Unless otherwise agreed

(a) Payment is due at the time and place at which the buyer is to receive the goods even though the place of shipment is the place of delivery; and (b) If the seller is authorized to send the goods he may ship them under reservation, and may tender the documents of title, but the buyer may inspect the goods after their arrival before payment is due unless such inspection is inconsistent with the terms of the contract (section 28-2-513[, Idaho Code]); and (c) If delivery is authorized and made by way of documents of title otherwise than by subsection (b) then payment is due regardless of where the goods are to be received (i) at the time and place at which the buyer is to receive delivery of the tangible documents or (ii) at the time the buyer is to receive delivery of the electronic documents and at the seller's place of business or if none, the seller's residence; and (d) Where the seller is required or authorized to ship the goods on credit the credit period runs from the time of shipment but post-dating the invoice or delaying its dispatch will correspondingly delay the starting of the credit period.

History.

1967, ch. 161, § 2-310, p. 351; am. 2004, ch. 42, § 6, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion at the end of subsection (b) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Cited Pern v. Stocks, 93 Idaho 866, 477 P.2d 108 (1970); Building Concepts, Ltd. v. Pickering, 114 Idaho 640, 759 P.2d 931 (Ct. App. 1988).

Decisions Under Prior Law

Cash sale.

Inspection of goods.

Cash Sale.

Where the buyer under a contract of sale was not entitled to possession until payment, the law presumed a cash sale, which is one where payment and delivery are concurrent. Western Seed Marketing Co. v. Pfost, 45 Idaho 340, 262 P. 514 (1927).

Inspection of Goods.

Where buyer of peaches diverted shipment being made to Laramie, Wyo., to Chicago, Ill., without examining the peaches, the question as to what was a reasonable time and place for buyer to examine peaches and notify seller of rejection of them for breach of warranty was for the jury. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Inspection of goods by buyer was to be made at destination before sale was completed, and a reasonable time therefor was allowed. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

RESEARCH REFERENCES

Am. Jur. 2d. — 17A Am. Jur. 2d, Contracts, § 481.

67 Am. Jur. 2d, Sales, § 272 et seq.

Official Comment

Prior Uniform Statutory Provision: Sections 42 and 47(2), Uniform Sales Act.

Changes: Completely rewritten in this and other sections.

Purposes of Changes: This section is drawn to reflect modern business methods of dealing at a distance rather than face to face. Thus: 1. Paragraph (a) provides that payment is due at the time and place "the buyer is to receive the goods" rather than at the point of delivery except in documentary shipment cases (paragraph (c)). This grants an opportunity for the exercise by the buyer of his preliminary right to inspection before paying even though under the delivery term the risk of loss may have

previously passed to him or the running of the credit period has already started.

2. Paragraph (b) while providing for inspection by the buyer before he pays, protects the seller. He is not required to give up possession of the goods until he has received payment, where no credit has been contemplated by the parties. The seller may collect through a bank by a sight draft against an order bill of lading "hold until arrival; inspection allowed." The obligations of the bank under such a provision are set forth in Part 5 of Article [Chapter] 4. Under subsection (c), in the absence of a credit term, the seller is permitted to ship under reservation and if he does payment is then due where and when the buyer is to receive delivery of the tangible documents of title. In the case of an electronic document of title, payment is due when the buyer is to receive delivery of the electronic document and at the seller's place of business, or if none, the seller's residence. Delivery as to documents of title is stated in Article 1, Section 1-201.

3. Unless otherwise agreed, the place for the delivery of the documents and payment is the buyer's city but the time for payment is only after arrival of the goods, since under paragraph (b), and Sections 2-512 and 2-513 the buyer is under no duty to pay prior to inspection. Tender of a document of title requires that the seller be ready, willing and able to transfer possession of a tangible document of title or control of an electronic document of title to the buyer.

4. Where the mode of shipment is such that goods must be unloaded immediately upon arrival, too rapidly to permit adequate inspection before receipt, the seller must be guided by the provisions of this Article [Chapter] on inspection which provide that if the seller wishes to demand payment before inspection, he must put an appropriate term into the contract. Even requiring payment against documents will not of itself have this desired result if the documents are to be held until the arrival of the goods. But under (b) and (c) if the terms are C.I.F., C.O.D., or cash against documents payment may be due before inspection.

5. Paragraph (d) states the common commercial understanding that an agreed credit period runs from the time of shipment or from that dating of the invoice which is commonly recognized as a representation of the time

of shipment. The provision concerning any delay in sending forth the invoice is included because such conduct results in depriving the buyer of his full notice and warning as to when he must be prepared to pay.

Cross References: Generally: Part 5.

Point 1: Section 2-509.

Point 2: Sections 2-505, 2-511, 2-512, 2-513 and Article [Chapter] 4.

Point 3: Sections 2-308(b), 2-512 and 2-513.

Point 4: Section 2-513(3)(b).

Definitional Cross References: "Buyer." Section 2-103.

"Delivery." Section 1-201.

"Document of title." Section 1-201.

"Goods." Section 2-105.

"Receipt of goods." Section 2-103.

"Seller." Section 2-103.

"Send." Section 1-201.

"Term." Section 1-201.

§ 28-2-311. Options and cooperation respecting performance. — (1) An agreement for sale which is otherwise sufficiently definite (subsection (3) of section 28-2-204[, Idaho Code]) to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within limits set by commercial reasonableness.

(2) Unless otherwise agreed specifications relating to assortment of the goods are at the buyer's option and except as otherwise provided in subsections (1)(c) and (3) of section 28-2-319[, Idaho Code,] specifications or arrangements relating to shipment are at the seller's option.

(3) Where such specification would materially affect the other party's performance but is not seasonably made or where one party's cooperation is necessary to the agreed performance of the other but is not seasonably forthcoming, the other party in addition to all other remedies (a) is excused for any resulting delay in his own performance; and (b) may also either proceed to perform in any reasonable manner or after the time for a material part of his own performance treat the failure to specify or to cooperate as a breach by failure to deliver or accept the goods.

History.

1967, ch. 161, § 2-311, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (1) and (2) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Good Faith.

Where, based upon the clear language of the contract and usage of trade, a buyer had the right to designate the fields from which an order of onions came, and the seller attempted to deliver onions that were not from the designated fields, the buyer rightfully rejected the non-conforming goods. Panike & Sons Farms, Inc. v. Smith, 147 Idaho 562, 212 P.3d 992 (2009).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 473 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) permits the parties to leave certain detailed particulars of performance to be filled in by either of them without running the risk of having the contract invalidated for indefiniteness. The party to whom the agreement gives power to specify the missing details is required to exercise good faith and to act in accordance with commercial standards so that there is no surprise and the range of permissible variation is limited by what is commercially reasonable. The "agreement" which permits one party so to specify may be found as well in a course of dealing, usage of trade, or implication from circumstances as in explicit language used by the parties.

2. Options as to assortment of goods or shipping arrangements are specifically reserved to the buyer and seller respectively under subsection (2) where no other arrangement has been made. This section rejects the test which mechanically and without regard to usage or the purpose of the option gave the option to the party "first under a duty to move" and applies instead a standard commercial interpretation to these circumstances. The "unless otherwise agreed" provision of this subsection covers not only express terms but the background and circumstances which enter into the agreement.

3. Subsection (3) applies when the exercise of an option or cooperation by one party is necessary to or materially affects the other party's performance, but it is not seasonably forthcoming; the subsection relieves the other party from the necessity for performance or excuses his delay in

performance as the case may be. The contract-keeping party may at his option under this subsection proceed to perform in any commercially reasonable manner rather than wait. In addition to the special remedies provided, this subsection also reserves "all other remedies." The remedy of particular importance in this connection is that provided for insecurity. Request may also be made pursuant to the obligation of good faith for a reasonable indication of the time and manner of performance for which a party is to hold himself ready.

4. The remedy provided in subsection (3) is one which does not operate in the situation which falls within the scope of Section 2-614 on substituted performance. Where the failure to cooperate results from circumstances set forth in that Section, the other party is under a duty to proffer or demand (as the case may be) substitute performance as a condition to claiming rights against the noncooperating party.

Cross References: Point 1: Sections 1-201, 2-204 and 1-203.

Point 3: Sections 1-203 and 2-609.

Point 4: Section 2-614.

Definitional Cross References: "Agreement." Section 1-201.

"Buyer." Section 2-103.

"Contract for sale." Section 2-106.

"Goods." Section 2-105.

"Party." Section 1-201.

"Remedy." Section 1-201.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

§ 28-2-312. Warranty of title and against infringement — Buyer's obligation against infringement. — (1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that

(a) the title conveyed shall be good, and its transfer rightful; and (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.

(2) A warranty under subsection (1) will be excluded or modified only by specific language or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.

(3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

History.

1967, ch. 161, § 2-312, p. 351.

CASE NOTES

Cited Flying Diamond Corp. v. Pennaluna & Co., 586 F.2d 707 (9th Cir. 1978).

Decisions Under Prior Law

Waiver Agreement.

A provision in the conditional sales contract that it might be assigned to a named bank without notice to purchaser, and, when assigned, should be free from any defense, counterclaim, or cross-complaint by the purchaser, was valid and would bar the defense of the breach of implied warranty. United States ex rel. Adm'r of Fed. Hous. Admin. v. Troy-Parisian, Inc., 115 F.2d

224 (9th Cir. 1940), cert. denied, 312 U.S. 699, 61 S. Ct. 739, 85 L. Ed. 1133 (1941).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 625 et seq.

C.J.S. — 77A C.J.S., Sales, § 421 et seq.

Official Comment

Prior Uniform Statutory Provision: Section 13, Uniform Sales Act.

Changes: Completely rewritten, the provisions concerning infringement being new.

Purposes of Changes: 1. Subsection (1) makes provision for a buyer's basic needs in respect to a title which he in good faith expects to acquire by his purchase, namely, that he receive a good, clean title transferred to him also in a rightful manner so that he will not be exposed to a lawsuit in order to protect it.

The warranty extends to a buyer whether or not the seller was in possession of the goods at the time the sale or contract to sell was made.

The warranty of quiet possession is abolished. Disturbance of quiet possession, although not mentioned specifically, is one way, among many, in which the breach of the warranty of title may be established.

The "knowledge" referred to in subsection 1(b) is actual knowledge as distinct from notice.

2. The provisions of this Article [Chapter] requiring notification to the seller within a reasonable time after the buyer's discovery of a breach apply to notice of a breach of the warranty of title, where the seller's breach was innocent. However, if the seller's breach was in bad faith he cannot be permitted to claim that he has been misled or prejudiced by the delay in giving notice. In such case the "reasonable" time for notice should receive a very liberal interpretation. Whether the breach by the seller is in good or bad faith Section 2-725 provides that the cause of action accrues when the breach occurs. Under the provisions of that section the breach of the

warranty of good title occurs when tender of delivery is made since the warranty is not one which extends to "future performance of the goods."

3. When the goods are part of the seller's normal stock and are sold in his normal course of business, it is his duty to see that no claim of infringement of a patent or trademark by a third party will mar the buyer's title. A sale by a person other than a dealer, however, raises no implication in its circumstances of such a warranty. Nor is there such an implication when the buyer orders goods to be assembled, prepared or manufactured on his own specifications. If, in such a case, the resulting product infringes a patent or trademark, the liability will run from buyer to seller. There is, under such circumstances, a tacit representation on the part of the buyer that the seller will be safe in manufacturing according to the specifications, and the buyer is under an obligation in good faith to indemnify him for any loss suffered.

4. This section rejects the cases which recognize the principle that infringements violate the warranty of title but deny the buyer a remedy unless he has been expressly prevented from using the goods. Under this Article [Chapter] "eviction" is not a necessary condition to the buyer's remedy since the buyer's remedy arises immediately upon receipt of notice of infringement; it is merely one way of establishing the fact of breach.

5. Subsection (2) recognizes that sales by sheriffs, executors, foreclosing lienors and persons similarly situated are so out of the ordinary commercial course that their peculiar character is immediately apparent to the buyer and therefore no personal obligation is imposed upon the seller who is purporting to sell only an unknown or limited right. This subsection does not touch upon and leaves open all questions of restitution arising in such cases, when a unique article so sold is reclaimed by a third party as the rightful owner.

6. The warranty of subsection (1) is not designated as an "implied" warranty, and hence is not subject to Section 2-316 (3). Disclaimer of the warranty of title is governed instead by subsection (2), which requires either specific language or the described circumstances.

Cross References: Point 1: Section 2-403.

Point 2: Sections 2-607 and 2-725.

Point 3: Section 1-203.

Point 4: Sections 2-609 and 2-725.

Point 6: Section 2-316.

Definitional Cross References: "Buyer." Section 2-103.

"Contract for sale." Section 2-106.

"Goods." Section 2-105.

"Person." Section 1-201.

"Right." Section 1-201.

"Seller." Section 2-103.

§ 28-2-313. Express warranties by affirmation, promise, description, sample. — (1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as “warrant” or “guarantee” or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller’s opinion or commendation of the goods does not create a warranty.

History.

1967, ch. 161, § 2-313, p. 351.

CASE NOTES

Reliance.

Revocation of acceptance.

Warranty by sample.

Advertising Materials.

Advertising material and pamphlets given by manufacturers for distribution by retailers can form the basis of an express warranty. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Application.

Buyer's affidavits sufficiently established that oral representations were made by seller regarding potato worm pesticide and raised a genuine issue of material fact as to the existence of an express warranty. Tolmie Farms, Inc. v. J.R. Simplot Co., 124 Idaho 607, 862 P.2d 299 (1993).

Driver and her passenger who collided with buyer's truck were not either "persons who were in the family or household" of the buyer or "a guest" in the buyer's home and, therefore, were not third party beneficiaries who could recover under a breach of an express warranty claim between used car dealer and buyer of truck which was involved in accident. Mugavero v. A-1 Auto Sales, Inc., 130 Idaho 554, 944 P.2d 151 (Ct. App. 1997).

Breach of Express Warranty.

Where the jury specifically found that suppliers not only breached an implied warranty of merchantability, but also found that an express warranty had been given that the wheat was spring wheat and that such express warranty had been breached, the suppliers were "sellers" within the purview of § 28-2-103(1)(d) and, hence, the breach of the express warranty provided a sufficient basis for the award of consequential damages. Nezperce Storage Co. v. Zenner, 105 Idaho 464, 670 P.2d 871 (1983); Cottonwood Elevator Co. v. Zenner, 105 Idaho 469, 670 P.2d 876 (1983).

By way of letter, a weather conditioning corporation made an express warranty that a dehumidifier was fit for the particular purpose of eliminating the odor and humidity problems at an athletic club, and there was substantial, competent evidence that the corporation breached the warranty because the dehumidifier was inadequate to maintain relative humidity in

the pool area, according to the industry standard. Keller v. Inland Metals All Weather Conditioning, Inc., 139 Idaho 233, 76 P.3d 977 (2003).

It was not error to deny sellers a directed verdict or judgment notwithstanding the verdict as to a buyer's breach of warranty claims because, (1) as to one asset, there was sufficient evidence to conclude a seller warranted more than a mere affirmation of the asset's value, (2) as to another asset, there also was sufficient evidence for a jury reasonably to conclude the seller warranted the buyer would own unique software, and (3) both warranties were breached. April Beguesse, Inc. v. Rammell, 156 Idaho 500, 328 P.3d 480 (2014).

Creation of Warranties.

Express warranties will not be created when there is clear proof of some fact which took the affirmation or description out of the agreement, or when the affirmation is merely of the value of the goods or constitutes puffery; a fact which will also negate some warranties is an examination by the buyer prior to his decision to purchase, and such examination would disclose clearly proven patent defects which are discoverable or latent defects which are discovered. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Where mobile home buyer discovered certain patent defects and agreed to accept the mobile home with those defects which seller expressly warranted would be repaired and seller gave buyer certain materials, i.e., the written contract, the manufacturer's warranty, the Mobile Home Owner's Manual, and various advertising pamphlets describing the mobile home, which contained a host of affirmations and descriptions, those affirmations became part of the basis of the bargain and, hence, constituted express warranties as to all aspects of the mobile home, except those defects which were discovered prior to the sale and which seller agreed to repair. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Although an express affirmation of fact regarding the quality of the potato seed sold by farm corporation may not have been made by the mere use of the term "certified," a warranty may have arisen through a "description" of the goods based on prior dealings; whether such a description was in fact made and whether it became part of the basis of the

bargain are questions of fact sufficient to preclude summary judgment. Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995).

Disclaimer.

Where, in a lease agreement, the disclaimer of express or implied warranties was conspicuously printed on the back side of the lease agreement in bold type of larger size and was incorporated into the modified contract, such a disclaimer effectively disclaimed the implied warranties of merchantability and fitness for a particular purpose. Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 541 P.2d 1184 (1975).

Existence of Sales Agreement.

This section does not require the existence of a sales agreement. Thus, a bargain is struck when the potential buyer agrees to test drive a vehicle, and representations made under these circumstances constitute express warranties. Green v. A.B. Hagglund & Soner, 634 F. Supp. 790 (D. Idaho 1986).

Persons Entitled to Protection of Warranties.

Where the employee of a potential buyer was injured while test driving a vehicle, the employee was entitled to the protection of any warranties extended to the buyer by the manufacturers or seller; the employee was the third-party beneficiary of any warranties extended to the buyer under § 28-2-318, and as an agent of the corporation, the employee was the "person" to whom the warranties were extended. Green v. A.B. Hagglund & Soner, 634 F. Supp. 790 (D. Idaho 1986).

Reliance.

The buyer of goods need not rely on an "affirmation of fact or promise" or "description" for the same to become "part of the basis of the bargain" and, hence, an express warranty. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Revocation of Acceptance.

Because a buyer may revoke acceptance only against the seller and because a finding that the purchasers had the right to revoke acceptance against automobile dealer is consistent with a finding that the dealer had not breached any warranties, jury verdict for purchasers was not inconsistent

and was permissible on revocation claim against dealer and on the lemon law claim against automobile manufacturer. Griffith v. Latham Motors, Inc., 128 Idaho 356, 913 P.2d 572 (1996).

Warranty by Sample.

Where there was testimony in the record that the "samples" shown were intended to be illustrative of the four-color process and of the kind of quality obtainable, rather than a sample of the particular features of the printing work which the printer was going to produce, it is clear that whether or not a sample by warranty was created was a question of fact for the trier of fact. Meredith Corp. v. Design & Lithography Ctr., Inc., 101 Idaho 391, 614 P.2d 414 (1980).

Cited Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Duff v. Bonner Bldg. Supply, Inc., 103 Idaho 432, 649 P.2d 391 (Ct. App. 1982).

Decisions Under Prior Law

Breach of warranty.

Implied warranty in sale.

Merchantability.

Notice given of substandard goods.

Oral warranty.

Recovery for breach of warranty.

Waiver agreement.

Breach of Warranty.

Where defects found in truck purchased were more than minor defects, evidence was sufficient to establish the elements necessary to constitute a breach of warranty. Morton v. Whitson, 45 Idaho 28, 260 P. 426 (1927).

Implied Warranty in Sale.

Where transaction was a sale by description raising an implied warranty that the article would correspond to the description, and such statement was fraudulent, the buyer's remedies were not confined to an action for breach

of warranty, but he might rescind the contract for fraud. J.I. Case Co. v. Bird, 51 Idaho 725, 11 P.2d 966 (1932).

Merchantability.

The rule as to warranty when the contract was silent is subject to the limitation in Idaho that the seller of personal property impliedly warrants that the goods are merchantable and the bulk of them conformable to sample or description. First Nat'l Bank v. Peterson, 47 Idaho 794, 279 P. 302 (1929).

Under the rule as modified by the statutes, a party may plead and prove that, as a matter of fact, the goods were neither merchantable nor the bulk of them up to a sample, but beyond that he may not venture. First Nat'l Bank v. Peterson, 47 Idaho 794, 279 P. 302 (1929).

Notice Given of Substandard Goods.

If goods furnished are not up to standard of sample, purchaser must use reasonable diligence in apprising vendor, make his objection, and refuse to accept further goods of the kind. Brown v. Scheurman, 22 Idaho 724, 128 P. 83 (1912).

Oral Warranty.

The seller's oral statement that a combine would be suitable for sidehill combining, save grain, and be trouble free was a warranty and a part of the sales agreement notwithstanding a printed statement in the written contract that the written order "together with the warranty provision on the back hereof is understood to be the entire contract between us." J.I. Case Credit Corp. v. Andreason, 90 Idaho 12, 408 P.2d 165 (1965).

Recovery for Breach of Warranty.

If buyer knows that goods are not as represented and was not misled by the representation, he is not entitled to recover for breach of warranty. Tomita v. Johnson, 49 Idaho 643, 290 P. 395 (1930).

Waiver Agreement.

A provision in the conditional sales contract that it might be assigned to a named bank without notice to purchaser, and, when assigned, should be free from any defense, counter-claim, or cross-complaint by the purchaser, was

valid and would bar the defense of the breach of implied warranty. United States ex rel. Adm'r of Fed. Hous. Admin. v. Troy-Parisian, Inc., 115 F.2d 224 (9th Cir. 1940), cert. denied, 312 U.S. 699, 61 S. Ct. 739, 85 L. Ed. 1133 (1941).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 655 et seq.

ALR. — Liability for warranties and representations in connection with the sale of air-conditioning equipment. 15 A.L.R.3d 1207.

Liability of product indorser or certifier for product-caused injury. 30 A.L.R.3d 181.

Liability for representations and express warranties in connection with sale of used motor vehicle. 36 A.L.R.3d 125.

Liability for warranty or representation that article, other than motor vehicle, is new. 36 A.L.R.3d 237.

Liability of manufacturer or seller of power lawnmower for injuries to user. 41 A.L.R.3d 986.

Promises or attempts by seller to repair goods as tolling statute of limitations for breach of warranty. 68 A.L.R.3d 1277.

Measure of damages in action for breach of warranty of title to personal property under UCC § 2-714. 94 A.L.R.3d 583.

What constitutes "affirmation of fact" giving rise to express warranty under UCC § 2-313 (1)(a). 94 A.L.R.3d 729.

Statement in advertisements, product brochures or other promotional materials as constituting "affirmation of fact" giving rise to express warranty under UCC § 2-313(1)(a). 83 A.L.R.6th 1.

Oral statement as constituting "affirmation of fact" giving rise to express warranty under UCC § 2-313(1)(a). 88 A.L.R.6th 1.

Statement in Contract Proposals, Contract Correspondence, or Contract Itself as Constituting "Affirmation of Fact" Giving Rise to Express Warranty Under U.C.C. § 2-313(1)(a). 94 A.L.R.6th 1.

Official Comment

Prior Uniform Statutory Provision: Sections 12, 14 and 16, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To consolidate and systematize basic principles with the result that: 1. "Express" warranties rest on "dickered" aspects of the individual bargain, and go so clearly to the essence of that bargain that words of disclaimer in a form are repugnant to the basic dickered terms. "Implied" warranties rest so clearly on a common factual situation or set of conditions that no particular language or action is necessary to evidence them and they will arise in such a situation unless unmistakably negated.

This section reverts to the older case law insofar as the warranties of description and sample are designated "express" rather than "implied."

2. Although this section is limited in its scope and direct purpose to warranties made by the seller to the buyer as part of a contract for sale, the warranty sections of this Article [Chapter] are not designed in any way to disturb those lines of case law growth which have recognized that warranties need not be confined either to sales contracts or to the direct parties to such a contract. They may arise in other appropriate circumstances such as in the case of bailments for hire, whether such bailment is itself the main contract or is merely a supplying of containers under a contract for the sale of their contents. The provisions of Section 2-318 on third party beneficiaries expressly recognize this case law development within one particular area. Beyond that, the matter is left to the case law with the intention that the policies of this Act may offer useful guidance in dealing with further cases as they arise.

3. The present section deals with affirmations of fact by the seller, descriptions of the goods or exhibitions of samples, exactly as any other part of a negotiation which ends in a contract is dealt with. No specific intention to make a warranty is necessary if any of these factors is made part of the basis of the bargain. In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement.

Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof. The issue normally is one of fact.

4. In view of the principle that the whole purpose of the law of warranty is to determine what it is that the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation. Thus, a contract is normally a contract for a sale of something describable and described. A clause generally disclaiming "all warranties, express or implied" cannot reduce the seller's obligation with respect to such description and therefore cannot be given literal effect under Section 2-316.

This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish. But in determining what they have agreed upon good faith is a factor and consideration should be given to the fact that the probability is small that a real price is intended to be exchanged for a pseudo-obligation.

5. Paragraph (1) (b) makes specific some of the principles set forth above when a description of the goods is given by the seller.

A description need not be by words. Technical specifications, blueprints and the like can afford more exact description than mere language and if made part of the basis of the bargain goods must conform with them. Past deliveries may set the description of quality, either expressly or impliedly by course of dealing. Of course, all descriptions by merchants must be read against the applicable trade usages with the general rules as to merchantability resolving any doubts.

6. The basic situation as to statements affecting the true essence of the bargain is no different when a sample or model is involved in the transaction. This section includes both a "sample" actually drawn from the bulk of goods which is the subject matter of the sale, and a "model" which is offered for inspection when the subject matter is not at hand and which has not been drawn from the bulk of the goods.

Although the underlying principles are unchanged, the facts are often ambiguous when something is shown as illustrative, rather than as a straight sample. In general, the presumption is that any sample or model just as any

affirmation of fact is intended to become a basis of the bargain. But there is no escape from the question of fact. When the seller exhibits a sample purporting to be drawn from an existing bulk, good faith of course requires that the sample be fairly drawn. But in mercantile experience the mere exhibition of a "sample" does not of itself show whether it is merely intended to "suggest" or to "be" the character of the subject-matter of the contract. The question is whether the seller has so acted with reference to the sample as to make him responsible that the whole shall have at least the values shown by it. The circumstances aid in answering this question. If the sample has been drawn from an existing bulk, it must be regarded as describing values of the goods contracted for unless it is accompanied by an unmistakable denial of such responsibility. If, on the other hand, a model of merchandise not on hand is offered, the mercantile presumption that it has become a literal description of the subject matter is not so strong, and particularly so if modification on the buyer's initiative impairs any feature of the model.

7. The precise time when words of description or affirmation are made or samples are shown is not material. The sole question is whether the language or samples or models are fairly to be regarded as part of the contract. If language is used after the closing of the deal (as when the buyer when taking delivery asks and receives an additional assurance), the warranty becomes a modification, and need not be supported by consideration if it is otherwise reasonable and in order (Section 2-209).

8. Concerning affirmations of value or a seller's opinion or commendation under subsection (2), the basic question remains the same: What statements of the seller have in the circumstances and in objective judgment become part of the basis of the bargain? As indicated above, all of the statements of the seller do so unless good reason is shown to the contrary. The provisions of subsection (2) are included, however, since common experience discloses that some statements or predictions cannot fairly be viewed as entering into the bargain. Even as to false statements of value, however, the possibility is left open that a remedy may be provided by the law relating to fraud or misrepresentation.

Cross References: Point 1: Section 2-316.

Point 2: Sections 1-102(3) and 2-318.

Point 3: Section 2-316(2) (b).

Point 4: Section 2-316.

Point 5: Sections 1-205(4) [1-303(4)] and 2-314.

Point 6: Section 2-316.

Point 7: Section 2-209.

Point 8: Section 1-103.

Definitional Cross References: “Buyer.” Section 2-103.

“Conforming.” Section 2-106.

“Goods.” Section 2-105.

“Seller.” Section 2-103.

§ 28-2-314. Implied warranty — Merchantability — Usage of trade. — (1) Unless excluded or modified (section 28-2-316[, Idaho Code]), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

(2) Goods to be merchantable must be at least such as

(a) pass without objection in the trade under the contract description; and

(b) in the case of fungible goods, are of fair average quality within the description; and

(c) are fit for the ordinary purposes for which such goods are used; and

(d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and

(e) are adequately contained, packaged, and labeled as the agreement may require; and

(f) conform to the promises or affirmations of fact made on the container or label if any.

(3) Unless excluded or modified (section 28-2-316[, Idaho Code]) other implied warranties may arise from course of dealing or usage of trade.

History.

1967, ch. 161, § 2-314, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (1) and (3) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Application.

Where lessor of motor scraper units was a merchant specializing in the sale and leasing of heavy construction equipment and the lessee relied on lessor's expertise when motor scraper units were leased, the implied warranty under this section was extended to the transaction. Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 541 P.2d 1184 (1975).

Burden of Proof.

In a buyer's action for breach of implied warranties of merchantability and fitness for a particular purpose arising from the sale of diseased cattle, the buyer had the burden of establishing by a preponderance of the evidence that the calves were warranted as healthy and fit for a particular use, that the calves were in fact diseased before they left the seller's control, and that the disease caused the resulting deaths. Martineau v. Walker, 97 Idaho 246, 542 P.2d 1165 (1975).

The burden is upon a plaintiff in a warranty cause of action to show not only the existence of a particular warranty, but also a breach arising from unsuitability of the goods at the time of delivery and a loss proximately

caused by such breach. Duff v. Bonner Bldg. Supply, Inc., 103 Idaho 432, 649 P.2d 391 (Ct. App. 1982), aff'd, 105 Idaho 123, 666 P.2d 650 (1983).

Circumstantial Evidence.

In arriving at its determination of a product's merchantability, the district court may properly infer the unmerchantability of a product from circumstantial evidence. Meldco, Inc. v. Hollytex Carpet Mills, Inc., 118 Idaho 265, 796 P.2d 142 (Ct. App. 1990).

Comparative Negligence Defense.

Comparative negligence is not a defense to a breach of warranty action where a plaintiff seeks recovery for the costs of repair and replacement of defective goods. Duff v. Bonner Bldg. Supply, Inc., 103 Idaho 432, 649 P.2d 391 (Ct. App. 1982), aff'd, 105 Idaho 123, 666 P.2d 650 (1983).

Disclaimer.

Where, in a lease agreement, the disclaimer of express or implied warranties was conspicuously printed on the back side of the lease agreement in bold type of larger size and was incorporated into the modified contract, such a disclaimer effectively disclaimed the implied warranties of merchantability and fitness for a particular purpose. Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 541 P.2d 1184 (1975).

Latent Defects.

Implied warranties can apply to goods with latent defects. Hansen-Rice, Inc. v. Celotex Corp., 414 F. Supp. 2d 970 (D. Idaho 2006).

Merchant.

Where lessor of car washing equipment did not manufacture or sell any equipment but only financed the purchase of equipment specifically selected by the lessee, the finance lessor was not a merchant and, thus, no implied warranty of merchantability existed in the lease transaction. All-States Leasing Co. v. Bass, 96 Idaho 873, 538 P.2d 1177 (1975).

A crane rental corporation which, in the course of its business, performed substantial maintenance work on the cranes was a merchant under this section. Essex Crane Rental Corp. v. Weyher/Livsey Constructors, Inc., 713

F. Supp. 1350 (D. Idaho 1989), rev'd on other grounds, 940 F.2d 1253 (9th Cir. 1991).

Merchantability.

Where floor drain grating for swimming pool complex was specially manufactured and substantially conformed to architect's specifications, the grating was of merchantable quality and could not be rejected for not conforming with contractor's order. Consolidated Supply Co. v. Babbitt, 96 Idaho 636, 534 P.2d 466 (1975).

The implied warranty of merchantability recognized in this section applies to transactions of both new and used goods. Dickerson v. Mountain View Equip. Co., 109 Idaho 711, 710 P.2d 621 (Ct. App. 1985).

The warranty of merchantability extends to used goods. Lee v. Peterson, 110 Idaho 601, 716 P.2d 1373 (Ct. App. 1986).

The warranty of merchantability operates independently from any express warranty, unless it is effectively disclaimed. Lee v. Peterson, 110 Idaho 601, 716 P.2d 1373 (Ct. App. 1986).

Where, within 60 to 90 days of installation motel carpet showed evidence of "cornrowing" (a condition whereby carpet fibers separate along the installed mat, giving the appearance of a "corn row") and had "uglied out" (a term used within the carpet industry, indicating that, although the carpet fiber has not actually disintegrated, the carpet is in such a state of appearance as to require replacement), the district court properly found that the carpet was unfit for the ordinary purposes for which it was to be used, and that manufacturer had breached an implied warranty of merchantability. Meldco, Inc. v. Hollytex Carpet Mills, Inc., 118 Idaho 265, 796 P.2d 142 (Ct. App. 1990).

Although proof of a defect generally supports a finding of unmerchantability, such proof is not required. Meldco, Inc. v. Hollytex Carpet Mills, Inc., 118 Idaho 265, 796 P.2d 142 (Ct. App. 1990).

Even if applicable to the car manufacturer, the implied warranty could not be read to require the distribution of a mouse proof vehicle; there was no showing of how the mice entered the vehicle, such that the theoretical defect could not be identified and there was insufficient evidence to submit

the issue to the jury. Powers v. Am. Honda Motor Co., 139 Idaho 333, 79 P.3d 154 (2003).

District court properly entered a judgment in favor of a company in the grower's contract dispute arising from the development of bacterial ring rot in two of the potato varieties grown by the company for the grower because, inter alia, statutory recertification was not required by the contract, the grower's actions — selling some of the uninfected potatoes and making a payment to the company — were inconsistent with the company's ownership of the seed, as the grower's acceptance of the uninfected potatoes reinstated the contract Silver Creek Seed, LLC v. Sunrain Varieties, LLC, 161 Idaho 270, 385 P.3d 448 (2016).

Questions of Fact.

In a buyer's action against the seller for breach of implied warranties of merchantability and fitness for a particular purpose arising from the sale of diseased cattle, whether the animals were diseased prior to the risk of loss passing to the buyer was a question for the trier of fact. Martineau v. Walker, 97 Idaho 246, 542 P.2d 1165 (1975).

Even assuming that potato seed sold by farm corporation that was infected with bacterial ring rot was unmerchantable, there remained a factual question relating to whether the seed was infected at the time of delivery which was sufficient to preclude summary judgment on the issue of breach of warranty of merchantability. Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995).

Revocation of Acceptance.

Because a buyer may revoke acceptance only against the seller and because a finding that the purchasers had the right to revoke acceptance against automobile dealer is consistent with a finding that the dealer had not breached any warranties. Jury verdict for purchasers was not inconsistent and was permissible on revocation claim against dealer and on the lemon law claim against automobile manufacturer. Griffith v. Latham Motors, Inc., 128 Idaho 356, 913 P.2d 572 (1996).

Substantial Evidence.

Where the plaintiff homeowner's evidence showed that the lumber he bought from the defendant building supply company, for use as wall

paneling in his house, was defective from the date of its purchase in that it exceeded the lumber moisture content acceptable in the industry, and that he suffered loss caused by shrinkage resulting from the excessive moisture content, the finding of a breach of an implied warranty of merchantability was supported by substantial and competent evidence and would not be disturbed on appeal. Duff v. Bonner Bldg. Supply, Inc., 103 Idaho 432, 649 P.2d 391 (Ct. App. 1982), aff'd, 105 Idaho 123, 666 P.2d 650 (1983).

Where buyer bought a used tractor and used it for only 200 hours and there was evidence that the tractor was unmerchantable at the time of delivery, the record supported the district court's finding of breach of an implied warranty of merchantability. Collier Carbon & Chem. Corp. v. Castle Butte, Inc., 109 Idaho 708, 710 P.2d 618 (Ct. App. 1985).

Test.

The appropriate test for determining whether an implied warranty of merchantability has been breached is to examine whether the goods were unmerchantable at the time of delivery. Dickerson v. Mountain View Equip. Co., 109 Idaho 711, 710 P.2d 621 (Ct. App. 1985).

Cited Hoffman v. Simplot Aviation, Inc., 97 Idaho 32, 539 P.2d 584 (1975); Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Nezperce Storage Co. v. Zenner, 105 Idaho 464, 670 P.2d 871 (1983); Cottonwood Elevator Co. v. Zenner, 105 Idaho 469, 670 P.2d 876 (1983); Steiner Corp. v. American Dist. Tel., 106 Idaho 787, 683 P.2d 435 (1984); Fernandez v. Western R.R. Bldrs., 112 Idaho 907, 736 P.2d 1361 (Ct. App. 1987); Tusch Enters. v. Coffin, 113 Idaho 37, 740 P.2d 1022 (1987); Myers v. A.O. Smith Harvestore Prods., Inc., 114 Idaho 432, 757 P.2d 695 (Ct. App. 1988).

Decisions Under Prior Law

Waiver agreement.

Express and Implied Warranty.

Express warranty governed over inconsistent implied warranty. Investors Mtg. Sec. Co. v. Strauss & Co., 50 Idaho 562, 298 P. 678 (1931) (express warranty that what seed was of certain variety held not inconsistent with implied warranty).

Where there was an express warranty inconsistent with the warranty implied by law, the express warranty proved would govern. Investors Mtg. Sec. Co. v. Strauss & Co., 50 Idaho 562, 298 P. 678 (1931).

Fitness.

Creation of implied warranty of fitness for a particular purpose does not require affirmations of fact by the seller, but requires only that the seller be made aware of the buyer's need, that the seller recommend a product, and that the buyer purchase the product as recommended. Robinson v. Williamsen Idaho Equip. Co., 94 Idaho 819, 498 P.2d 1292 (1972).

Instructions.

An affirmation of fact by the seller was not an indispensable fact in the creation of an implied warranty, and the court properly corrected an instruction as follows, "You are instructed that in order that a sale shall be upon an express warranty, there must be two factors present, first, an affirmation of a fact by the seller, with reference to the thing to be sold, and second, an intention on the part of the seller that his affirmation shall be a warranty to the buyer." Branom v. Smith Frozen Foods of Idaho, Inc., 83 Idaho 502, 365 P.2d 958 (1961).

Where the second sentence of an instruction was merely a restatement of the first sentence of an instruction that there was an implied warranty that the swine would be reasonably fit for the buyer's purpose, where the buyer expressly or by implication made known to the seller the purpose for which he was buying the swine, the instruction was not erroneous as not stating the law in the case where the issue was whether the hogs were free and immune from hog cholera. Anderson v. Blackfoot Livestock Comm'n Co., 85 Idaho 64, 375 P.2d 704 (1962).

Merchantability.

Under former law, the seller of personal property impliedly warranted that the goods were merchantable. In other words, the statute interjected a warranty strictly limited in its nature into a contract which was silent as to warranties. First Nat'l Bank v. Peterson, 47 Idaho 794, 279 P. 302 (1929).

Recommendation by, and reliance on seller need not be shown to establish an implied warranty of merchantability. Robinson v. Williamsen Idaho Equip. Co., 94 Idaho 819, 498 P.2d 1292 (1972).

Pleading.

It was proper for buyer to plead and prove that goods were neither merchantable nor bulk of them up to the sample, but he could not prove false and fraudulent representations as to quality without pleading this. First Nat'l Bank v. Peterson, 47 Idaho 794, 279 P. 302 (1929).

Complaint did not state a cause of action for damages based on breach of implied warranty in sale of explosives where the complaint alleged that the plaintiff had continued to use explosives over a period of time despite a large number of failures. Coleman v. Carter, 77 Idaho 210, 289 P.2d 932 (1955).

In a complaint for breach of warranty in sale of explosives for use in excavation for sewer an allegation "that plaintiff had to remove rock by mechanical means at a great expense to his damage" was not sufficient pleading of measure of damages. Coleman v. Carter, 77 Idaho 210, 289 P.2d 932 (1955).

Waiver Agreement.

A provision in the conditional sales contract that it might be assigned to a named bank without notice to purchaser, and, when assigned, should be free from any defense, counter-claim, or cross-complaint by the purchaser, was valid and would bar the defense of the breach of implied warranty. United States ex rel. Adm'r of Fed. Hous. Admin. v. Troy-Parisian, Inc., 115 F.2d 224 (9th Cir. 1940), cert. denied, 312 U.S. 699, 61 S. Ct. 739, 85 L. Ed. 1133 (1941).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 27.

67A Am. Jur. 2d, Sales, § 676 et seq.

ALR. — Contributory negligence or assumption of risk as defense to action for personal injury, death or property damage resulting from alleged breach of implied warranty. 4 A.L.R.3d 501.

Liability on implied warranties in sale of used motor vehicle. 22 A.L.R.3d 1387.

What are "merchantable" goods within meaning of UCC § 2-314 dealing with implied warranty of merchantability. 83 A.L.R.3d 694.

Who is "merchant" under UCC § 2-314(1) dealing with implied warranties of merchantability. 83 A.L.R.3d 694.

Who is "merchant" under UCC § 2-314(1) dealing with implied warranties or merchantability. 91 A.L.R.3d 876.

Official Comment

Prior Uniform Statutory Provision: Section 15(2), Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: This section, drawn in view of the steadily developing case law on the subject, is intended to make it clear that:

1. The seller's obligation applies to present sales as well as to contracts to sell subject to the effects of any examination of specific goods. (Subsection (2) of Section 2-316). Also, the warranty of merchantability applies to sales for use as well as to sales for resale.

2. The question when the warranty is imposed turns basically on the meaning of the terms of the agreement as recognized in the trade. Goods delivered under an agreement made by a merchant in a given line of trade must be of a quality comparable to that generally acceptable in that line of trade under the description or other designation of the goods used in the agreement. The responsibility imposed rests on any merchant-seller, and the absence of the words "grower or manufacturer or not" which appeared in Section 15 (2) of the Uniform Sales Act does not restrict the applicability of this section.

3. A specific designation of goods by the buyer does not exclude the seller's obligation that they be fit for the general purposes appropriate to such goods. A contract for the sale of second-hand goods, however, involves only such obligation as is appropriate to such goods for that is their contract description. A person making an isolated sale of goods is not a "merchant" within the meaning of the full scope of this section and, thus, no warranty of merchantability would apply. His knowledge of any defects not apparent on inspection would, however, without need for express agreement and in keeping with the underlying reason of the present section and the provisions on good faith, impose an obligation that known material but hidden defects be fully disclosed.

4. Although a seller may not be a "merchant" as to the goods in question, if he states generally that they are "guaranteed" the provisions of this section may furnish a guide to the content of the resulting express warranty. This has particular significance in the case of second-hand sales, and has further significance in limiting the effect of fine-print disclaimer clauses where their effect would be inconsistent with large-print assertions of "guarantee."

5. The second sentence of subsection (1) covers the warranty with respect to food and drink. Serving food or drink for value is a sale, whether to be consumed on the premises or elsewhere. Cases to the contrary are rejected. The principal warranty is that stated in subsections (1) and (2) (c) of this section.

6. Subsection (2) does not purport to exhaust the meaning of "merchantable" nor to negate any of its attributes not specifically mentioned in the text of the statute, but arising by usage of trade or through case law. The language used is "must be at least such as . . . ," and the intention is to leave open other possible attributes of merchantability.

7. Paragraphs (a) and (b) of subsection (2) are to be read together. Both refer, as indicated above, to the standards of that line of the trade which fits the transaction and the seller's business. "Fair average" is a term directly appropriate to agricultural bulk products and means goods centering around the middle belt of quality, not the least or the worst that can be understood in the particular trade by the designation, but such as can pass "without objection." Of course a fair percentage of the least is permissible but the

goods are not “fair average” if they are all of the least or worst quality possible under the description. In cases of doubt as to what quality is intended, the price at which a merchant closes a contract is an excellent index of the nature and scope of his obligation under the present section.

8. Fitness for the ordinary purposes for which goods of the type are used is a fundamental concept of the present section and is covered in paragraph (c). As stated above, merchantability is also a part of the obligation owing to the purchaser for use. Correspondingly, protection, under this aspect of the warranty, of the person buying for resale to the ultimate consumer is equally necessary, and merchantable goods must therefore be “honestly” resalable in the normal course of business because they are what they purport to be.

9. Paragraph (d) on evenness of kind, quality and quantity follows case law. But precautionary language has been added as a reminder of the frequent usages of trade which permit substantial variations both with and without an allowance or an obligation to replace the varying units.

10. Paragraph (e) applies only where the nature of the goods and of the transaction require a certain type of container, package or label. Paragraph (f) applies, on the other hand, wherever there is a label or container on which representations are made, even though the original contract, either by express terms or usage of trade, may not have required either the labelling or the representation. This follows from the general obligation of good faith which requires that a buyer should not be placed in the position of reselling or using goods delivered under false representations appearing on the package or container. No problem of extra consideration arises in this connection since, under this Article [Chapter] an obligation is imposed by the original contract not to deliver mislabeled articles, and the obligation is imposed where mercantile good faith so requires and without reference to the doctrine of consideration.

11. Exclusion or modification of the warranty of merchantability, or of any part of it, is dealt with in the section to which the text of the present section makes explicit precautionary references. That section must be read with particular reference to its subsection (4) on limitation of remedies. The warranty of merchantability, wherever it is normal, is so commonly taken

for granted that its exclusion from the contract is a matter threatening surprise and therefore requiring special precaution.

12. Subsection (3) is to make explicit that usage of trade and course of dealing can create warranties and that they are implied rather than express warranties and thus subject to exclusion or modification under Section 2-316. A typical instance would be the obligation to provide pedigree papers to evidence conformity of the animal to the contract in the case of a pedigreed dog or blooded bull.

13. In an action based on breach of warranty, it is of course necessary to show not only the existence of the warranty but the fact that the warranty was broken and that the breach of the warranty was the proximate cause of the loss sustained. In such an action an affirmative showing by the seller that the loss resulted from some action or event following his own delivery of the goods can operate as a defense. Equally, evidence indicating that the seller exercised care in the manufacture, processing or selection of the goods is relevant to the issue of whether the warranty was in fact broken. Action by the buyer following an examination of the goods which ought to have indicated the defect complained of can be shown as matter bearing on whether the breach itself was the cause of the injury.

Cross References: Point 1: Section 2-316.

Point 3: Sections 1-203 and 2-104.

Point 5: Section 2-315.

Point 11: Section 2-316.

Point 12: Sections 1-201, 1-205 [1-303] and 2-316.

Definitional Cross References: “Agreement.” Section 1-201.

“Contract.” Section 1-201.

“Contract for sale.” Section 2-106.

“Goods.” Section 2-105.

“Merchant.” Section 2-104.

“Seller.” Section 2-103.

§ 28-2-315. Implied warranty — Fitness for particular purpose. — Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

History.

1967, ch. 161, § 2-315, p. 351.

CASE NOTES

Application.

Where lessor of motor scraper units was a merchant specializing in the sale and leasing of heavy construction equipment and the lessee relied on lessor's experience when motor scraper units were leased, the implied warranty under this section was extended to the transaction. Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 541 P.2d 1184 (1975).

Since buyer of potato seed specifically requested certified seed and there was no evidence that buyer relied upon seller's advice, skill or judgment, no warranty of fitness for a particular purpose arose and lower court's denial of summary judgment on this issue was reversed. Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995).

This section does not create liability for failing to comply with labeling regulations. Millenkamp v. Davisco Foods Int'l, Inc., 562 F.3d 971 (9th Cir. 2009).

Burden of Proof.

In a buyer's action for breach of implied warranties of merchantability and fitness for a particular purpose, arising from the sale of diseased cattle, the buyer had the burden of establishing by a preponderance of the evidence that the calves were warranted as healthy and fit for a particular use, that the calves were diseased before they left the seller's control, and that the disease caused the resulting deaths. Martineau v. Walker, 97 Idaho 246, 542 P.2d 1165 (1975).

Disclaimer.

Where, in a lease agreement, the disclaimer of express or implied warranties was conspicuously printed on the back side of the lease agreement in bold type of larger size and was incorporated into the modified contract, such a disclaimer effectively disclaimed the implied warranties of merchantability and fitness for a particular purpose. Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 541 P.2d 1184 (1975).

Economic Damages.

Claim of purchaser of irrigation system for negligent misrepresentation alleging that the defendants negligently failed to disclose that the irrigation system was not designed for its specific needs and that, as a result, purchaser suffered economic loss in the form of reduced crop yield was properly dismissed since the remedy for a claim for purely economic damages falls within the implied warranty of fitness for a particular purpose under this section. This section and the court's decision in *Clark v. International Harvester*, 99 Idaho 326, 581 P.2d 784 (1978), preclude a products liability action sounding in tort under circumstances where there is no personal injury or damage to property alleged. G & M Farms v. Funk Irrigation Co., 119 Idaho 514, 808 P.2d 851 (1991).

Implied Warranty of Fitness.

Where floor drain grating for swimming pool complex was specially manufactured and substantially conformed to architect's specifications,

there was no implied warranty of fitness for a particular purpose. Consolidated Supply Co. v. Babbitt, 96 Idaho 636, 534 P.2d 466 (1975).

Where the lessor of car washing equipment made no suggestion or recommendation as to a choice of an automatic system to meet lessee's need and where the lessee made his selection on the basis of his own inspection of the manufacturer's literature and his impressions of the equipment based upon statements made by the manufacturer's salesmen, no implied warranty of fitness for a particular purpose existed. All-States Leasing Co. v. Bass, 96 Idaho 873, 538 P.2d 1177 (1975).

Pleading.

In an action for damages for breach of warranty brought by purchasers of a mare, where the mare was purchased for breeding purposes but was later found to be unable to conceive, the complaint, which did not cite this section nor use the term "implied warranty," was adequate to state a cause of action for breach of implied warranty of fitness for a particular purpose, since the underlying facts and allegations supported the claim. Whitehouse v. Lange, 128 Idaho 129, 910 P.2d 801 (Ct. App. 1996).

Questions of Fact.

In a buyer's action against the seller for breach of implied warranties of merchantability and fitness for a particular purpose arising from the sale of diseased cattle, whether the animals were diseased prior to the risk of loss passing to the buyer was a question for the trier of fact. Martineau v. Walker, 97 Idaho 246, 542 P.2d 1165 (1975).

Cited Hoffman v. Simplot Aviation, Inc., 97 Idaho 32, 539 P.2d 584 (1975); Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Duff v. Bonner Bldg. Supply, Inc., 103 Idaho 432, 649 P.2d 391 (Ct. App. 1982); Steiner Corp. v. American Dist. Tel., 106 Idaho 787, 683 P.2d 435 (1984); Tusch Enters. v. Coffin, 113 Idaho 37, 740 P.2d 1022 (1987); Myers v. A.O. Smith Harvestore Prods., Inc., 114 Idaho 432, 757 P.2d 695 (Ct. App. 1988).

Decisions Under Prior Law

Implied Warranty of Fitness.

Where one desiring seed makes known to a dealer his needs for planting, and a selection was made upon recommendation by the seller, there arose an implied warranty that the seed was suitable for the purpose intended. Tomita v. Johnson, 49 Idaho 643, 290 P. 395 (1930).

Where buyer, expressly or by implication, made known to the seller the particular purpose for which the goods were required, and buyer relied on the seller's judgment, there was an implied warranty that the goods should be reasonably fit for such purpose. Investors Mtg. Sec. Co. v. Strauss & Co., 50 Idaho 562, 298 P. 678 (1931).

Implied warranties for quality or fitness were coextensive. National Motor Serv. Co. v. Walters, 85 Idaho 349, 379 P.2d 643 (1963).

Where the buyer informed the seller that he desired a combine for sidehill combining, there was an implied warranty that the combine sold was fit for such purpose. J.I. Case Credit Corp. v. Andreason, 90 Idaho 12, 408 P.2d 165 (1965).

The sale of hogs for breeding purposes carried with it an implied warranty that they were fit for such purpose and the fact that they were infected with a disease that rendered them useless for such purpose was a breach of such warranty. Paullus v. Liedkie, 92 Idaho 323, 442 P.2d 733 (1968).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 625 et seq.

ALR. — Contributory negligence or assumption of risk as defense to action for personal injury, death or property damage resulting from alleged breach of implied warranty. 4 A.L.R.3d 501.

Liability on implied warranties in sale of used motor vehicle. 22 A.L.R.3d 1387.

Modern status of rules as to existence of implied warranty of habitability or fitness for use of leased premises. 40 A.L.R.3d 646.

What constitutes "particular purpose" within meaning of UCC § 2-315 dealing with implied warranty of fitness. 83 A.L.R.3d 669.

Official Comment

Prior Uniform Statutory Provision: Section 15 (1), (4), (5), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: 1. Whether or not this warranty arises in any individual case is basically a question of fact to be determined by the circumstances of the contracting. Under this section the buyer need not bring home to the seller actual knowledge of the particular purpose for which the goods are intended or of his reliance on the seller's skill and judgment, if the circumstances are such that the seller has reason to realize the purpose intended or that the reliance exists. The buyer, of course, must actually be relying on the seller.

2. A "particular purpose" differs from the ordinary purpose for which the goods are used in that it envisages a specific use by the buyer which is peculiar to the nature of his business whereas the ordinary purposes for which goods are used are those envisaged in the concept of merchantability and go to uses which are customarily made of the goods in question. For example, shoes are generally used for the purpose of walking upon ordinary ground, but a seller may know that a particular pair was selected to be used for climbing mountains.

A contract may of course include both a warranty of merchantability and one of fitness for a particular purpose.

The provisions of this Article [Chapter] on the cumulation and conflict of express and implied warranties must be considered on the question of inconsistency between or among warranties. In such a case any question of fact as to which warranty was intended by the parties to apply must be resolved in favor of the warranty of fitness for particular purpose as against all other warranties except where the buyer has taken upon himself the responsibility of furnishing the technical specifications.

3. In connection with the warranty of fitness for a particular purpose the provisions of this Article [Chapter] on the allocation or division of risks are particularly applicable in any transaction in which the purpose for which the goods are to be used combines requirements both as to the quality of the goods themselves and compliance with certain laws or regulations. How the

risks are divided is a question of fact to be determined, where not expressly contained in the agreement, from the circumstances of contracting, usage of trade, course of performance and the like, matters which may constitute the "otherwise agreement" of the parties by which they may divide the risk or burden.

4. The absence from this section of the language used in the Uniform Sales Act in referring to the seller, "whether he be the grower or manufacturer or not," is not intended to impose any requirement that the seller be a grower or manufacturer. Although normally the warranty will arise only where the seller is a merchant with the appropriate "skill or judgment," it can arise as to nonmerchants where this is justified by the particular circumstances.

5. The elimination of the "patent or other trade name" exception constitutes the major extension of the warranty of fitness which has been made by the cases and continued in this Article [Chapter]. Under the present section the existence of a patent or other trade name and the designation of the article by that name, or indeed in any other definite manner, is only one of the facts to be considered on the question of whether the buyer actually relied on the seller, but it is not of itself decisive of the issue. If the buyer himself is insisting on a particular brand he is not relying on the seller's skill and judgment and so no warranty results. But the mere fact that the article purchased has a particular patent or trade name is not sufficient to indicate nonreliance if the article has been recommended by the seller as adequate for the buyer's purposes.

6. The specific reference forward in the present section to the following section on exclusion or modification of warranties is to call attention to the possibility of eliminating the warranty in any given case. However it must be noted that under the following section the warranty of fitness for a particular purpose must be excluded or modified by a conspicuous writing.

Cross References: Point 2: Sections 2-314 and 2-317.

Point 3: Section 2-303.

Point 6: Section 2-316.

Definitional Cross References: "Buyer." Section 2-103.

"Goods." Section 2-105.

“Seller.” Section 2-103.

§ 28-2-316. Exclusion or modification of warranties. — (1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this chapter on parol or extrinsic evidence (section 28-2-202[, Idaho Code]) negation or limitation is inoperative to the extent that such construction is unreasonable.

(2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is," "with all faults" or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty; and

(b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and

(c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade.

(4) Remedies for breach of warranty can be limited in accordance with the provisions of this chapter on liquidation or limitation of damages and on contractual modification of remedy (sections 28-2-718 and 28-2-719[, Idaho Code]).

History.

1967, ch. 161, § 2-316, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (1) and (4) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Disclaimer.

Where, in a lease agreement, the disclaimer of express or implied warranties was conspicuously printed on the back side of the lease agreement in bold type of larger size and was incorporated into the modified contract, such a disclaimer effectively disclaimed the implied warranties of merchantability and fitness for a particular purpose. Glenn Dick Equip. Co. v. Galey Constr., Inc., 97 Idaho 216, 541 P.2d 1184 (1975).

Where contract contained language that purported to disclaim, among other things, "all warranties, express or implied," but contract and other information supplied to buyer contained affirmations which became express warranties, seller did not effectively disclaim the express warranties. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Where the only alleged disclaimer was the statement in the acceptance form that the 30-day warranty was "in lieu of all other warranties and/or representations," the acceptance form failed to make it "plain" that no implied warranty existed; therefore, the disclaimer of the warranty of

merchantability was not valid. Lee v. Peterson, 110 Idaho 601, 716 P.2d 1373 (Ct. App. 1986).

Although the UCC does not explicitly require the term “as is” to be conspicuous, an inconspicuously inserted term may fail to make plain that there is no implied warranty. Fernandez v. Western R.R. Bldrs., 112 Idaho 907, 736 P.2d 1361 (Ct. App. 1987).

Sales ticket containing the almost illegible words “as is” alone would not suffice to disclaim an implied warranty or to exclude reliance upon a contract description. Fernandez v. Western R.R. Bldrs., 112 Idaho 907, 736 P.2d 1361 (Ct. App. 1987).

A purchase order, which directed and required the buyer’s signature on the reverse side, under disclaimer language written and labelled as a disclaimer in large, bold, capital letters, was conspicuous and the language effectively excluded implied warranties of merchantability and fitness for a particular purpose. Myers v. A.O. Smith Harvestore Prods., Inc., 114 Idaho 432, 757 P.2d 695 (Ct. App. 1988).

Seller effectively disclaimed all implied warranties where a course of dealing was established by over 160 mail invoices over four years each containing a disclaimer, and where tanks containing the purchased pesticide always carried a valid warranty disclaimer on the side. Tolmie Farms, Inc. v. J.R. Simplot Co., 124 Idaho 607, 862 P.2d 299 (1993).

Used car dealership excluded the warranty of merchantability from the sale contract for a used Jeep it sold to a consumer; the sale contract stated: “This unit sold as is. No warranty or guarantee stated or implied.” The buyer was not permitted to revoke his acceptance upon later discovering that the Jeep previously sustained collision damage that was insufficiently repaired. Haight v. Dale’s Used Cars, Inc., 139 Idaho 853, 87 P.3d 962 (Ct. App. 2003).

Examination of Goods.

In an action for damages for breach of warranty brought by purchasers of a mare, where the veterinarian’s examination of the mare took place after the sale contract had been formed and the mare had been delivered to the purchasers, the examination could not be effective to exclude an implied

warranty. Whitehouse v. Lange, 128 Idaho 129, 910 P.2d 801 (Ct. App. 1996).

Express Limited Warranty.

There was sufficient evidence to uphold the jury's finding that defendant's express limited warranty on an aircraft for 365 days or 1,000 flight hours, with its disclaimer of all other warranties, express or implied, effectively disposed of plaintiffs' other express and implied warranty claims. Management Catalysts v. Turbo W. Corpac, Inc., 119 Idaho 626, 809 P.2d 487 (1991).

Driver and her passenger who collided with buyer's truck were not either "persons who were in the family or household" of the buyer or "a guest" in the buyer's home and, therefore, were not third party beneficiaries who could recover under a breach of an express warranty claim between used car dealer and buyer of truck which was involved in accident. Mugavero v. A-1 Auto Sales, Inc., 130 Idaho 554, 944 P.2d 151 (Ct. App. 1997).

Latent Defects.

Warranties against latent defects that are not discoverable by the pre-contract examination are not excluded by terms of this section. Whitehouse v. Lange, 128 Idaho 129, 910 P.2d 801 (Ct. App. 1996).

Limitation of Remedies.

Where jury, under correct instructions, could have found that express warranties on mobile home were breached in various particulars, remedy of buyers was not limited by contract language disavowing any liability and stating that the manufacturer's written warranty would apply nor was repair intended to be the exclusive remedy of the buyer. If the contract limitation language was argued as excluding all remedies against the seller, it was unconscionable and, if the language was argued as creating a limited remedy of repair, it failed because such was not clearly expressed in the contract. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

In the situation where farmer bought certified potato seed from dealer and seed was later found to be infected by bacterial ring rot, because factual questions remained as to whether there were any terms in the parties' agreement excluding warranties or limiting remedies and as to whether

there was an applicable course of dealing or trade usage limiting remedies, the lower court's order denying summary judgment on this issue was affirmed. Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995).

Cited All-States Leasing Co. v. Bass, 96 Idaho 873, 538 P.2d 1177 (1975); Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Adkison Corp. v. American Bldg. Co., 107 Idaho 406, 690 P.2d 341 (1984); Snake River Equip. Co. v. Christensen, 107 Idaho 541, 691 P.2d 787 (Ct. App. 1984).

Decisions Under Prior Law

Unforeseen Defects.

The seller of a heifer for breeding purposes was not held under the doctrine of implied warranty for defects which he could not foresee. McMaster v. Warner, 44 Idaho 544, 258 P. 547 (1927).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 722 et seq.

ALR. — Construction and effect of affirmative provision in contract of sale by which purchaser agrees to take article "as is," in the condition in which it is, or equivalent term. 24 A.L.R.3d 465.

Validity of disclaimer of warranty clauses in sale of new automobile. 54 A.L.R.3d 1217.

Construction and effect of UCC § 2-316(2) providing that implied warranty disclaimer must be "conspicuous." 73 A.L.R.3d 248.

Official Comment

Prior Uniform Statutory Provision: See sections 15 and 71, Uniform Sales Act.

Purposes: 1. This section is designed principally to deal with those frequent clauses in sales contracts which seek to exclude "all warranties, express or implied." It seeks to protect a buyer from unexpected and unbargained language of disclaimer by denying effect to such language

when inconsistent with language of express warranty and permitting the exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise.

2. The seller is protected under this Article [Chapter] against false allegations of oral warranties by its provisions on parol and extrinsic evidence and against unauthorized representations by the customary “lack of authority” clauses. This Article [Chapter] treats the limitation or avoidance of consequential damages as a matter of limiting remedies for breach, separate from the matter of creation of liability under a warranty. If no warranty exists, there is of course no problem of limiting remedies for breach of warranty. Under subsection (4) the question of limitation of remedy is governed by the sections referred to rather than by this section.

3. Disclaimer of the implied warranty of merchantability is permitted under subsection (2), but with the safeguard that such disclaimers must mention merchantability and in case of a writing must be conspicuous.

4. Unlike the implied warranty of merchantability, implied warranties of fitness for a particular purpose may be excluded by general language, but only if it is in writing and conspicuous.

5. Subsection (2) presupposes that the implied warranty in question exists unless excluded or modified. Whether or not language of disclaimer satisfies the requirements of this section, such language may be relevant under other sections to the question whether the warranty was ever in fact created. Thus, unless the provisions of this Article [Chapter] on parol and extrinsic evidence prevent, oral language of disclaimer may raise issues of fact as to whether reliance by the buyer occurred and whether the seller had “reason to know” under the section on implied warranty of fitness for a particular purpose.

6. The exceptions to the general rule set forth in paragraphs (a), (b) and (c) of subsection (3) are common factual situations in which the circumstances surrounding the transaction are in themselves sufficient to call the buyer’s attention to the fact that no implied warranties are made or that a certain implied warranty is being excluded.

7. Paragraph (a) of subsection (3) deals with general terms such as “as is,” “as they stand,” “with all faults,” and the like. Such terms in ordinary

commercial usage are understood to mean that the buyer takes the entire risk as to the quality of the goods involved. The terms covered by paragraph (a) are in fact merely a particularization of paragraph (c) which provides for exclusion or modification of implied warranties by usage of trade.

8. Under paragraph (b) of subsection (3) warranties may be excluded or modified by the circumstances where the buyer examines the goods or a sample or model of them before entering into the contract. "Examination" as used in this paragraph is not synonymous with inspection before acceptance or at any other time after the contract has been made. It goes rather to the nature of the responsibility assumed by the seller at the time of the making of the contract. Of course if the buyer discovers the defect and uses the goods anyway, or if he unreasonably fails to examine the goods before he uses them, resulting injuries may be found to result from his own action rather than proximately from a breach of warranty. See Sections 2-314 and 2-715 and comments thereto.

In order to bring the transaction within the scope of "refused to examine" in paragraph (b), it is not sufficient that the goods are available for inspection. There must in addition be a demand by the seller that the buyer examine the goods fully. The seller by the demand puts the buyer on notice that he is assuming the risk of defects which the examination ought to reveal. The language "refused to examine" in this paragraph is intended to make clear the necessity for such demand.

Application of the doctrine of "caveat emptor" in all cases where the buyer examines the goods regardless of statements made by the seller is, however, rejected by this Article [Chapter]. Thus, if the offer of examination is accompanied by words as to their merchantability or specific attributes and the buyer indicates clearly that he is relying on those words rather than on his examination, they give rise to an "express" warranty. In such cases the question is one of fact as to whether a warranty of merchantability has been expressly incorporated in the agreement. Disclaimer of such an express warranty is governed by subsection (1) of the present section.

The particular buyer's skill and the normal method of examining goods in the circumstances determine what defects are excluded by the examination. A failure to notice defects which are obvious cannot excuse

the buyer. However, an examination under circumstances which do not permit chemical or other testing of the goods would not exclude defects which could be ascertained only by such testing. Nor can latent defects be excluded by a simple examination. A professional buyer examining a product in his field will be held to have assumed the risk as to all defects which a professional in the field ought to observe, while a nonprofessional buyer will be held to have assumed the risk only for such defects as a layman might be expected to observe.

9. The situation in which the buyer gives precise and complete specifications to the seller is not explicitly covered in this section, but this is a frequent circumstance by which the implied warranties may be excluded. The warranty of fitness for a particular purpose would not normally arise since in such a situation there is usually no reliance on the seller by the buyer. The warranty of merchantability in such a transaction, however, must be considered in connection with the next section on the cumulation and conflict of warranties. Under paragraph (c) of that section in case of such an inconsistency the implied warranty of merchantability is displaced by the express warranty that the goods will comply with the specifications. Thus, where the buyer gives detailed specifications as to the goods, neither of the implied warranties as to quality will normally apply to the transaction unless consistent with the specifications.

Cross References: Point 2: Sections 2-202, 2-718 and 2-719.

Point 7: Sections 1-205 [1-303] and 2-208.

Definitional Cross References: “Agreement.” Section 1-201.

“Buyer.” Section 2-103.

“Contract.” Section 1-201.

“Course of dealing.” Section 1-205 [1-303].

“Goods.” Section 2-105.

“Remedy.” Section 1-201.

“Seller.” Section 2-103.

“Usage of trade.” Section 1-205 [1-303].

§ 28-2-317. Cumulation and conflict of warranties express or implied.

— Warranties whether express or implied shall be construed as consistent with each other and as cumulative, but if such construction is unreasonable the intention of the parties shall determine which warranty is dominant. In ascertaining that intention the following rules apply:

(a) Exact or technical specifications displace an inconsistent sample or model or general language of description.

(b) A sample from an existing bulk displaces inconsistent general language of description.

(c) Express warranties displace inconsistent implied warranties other than an implied warranty of fitness for a particular purpose.

History.

1967, ch. 161, § 2-317, p. 351.

CASE NOTES

Warranties Not in Conflict.

Where used equipment warranty guaranteed the operation and parts performance of transmission for a full 90 days, such express warranty was congruous with an implied warranty of merchantability; the express warranty did not supersede the implied warranty of merchantability. Dickerson v. Mountain View Equip. Co., 109 Idaho 711, 710 P.2d 621 (Ct. App. 1985).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 597 et seq.

Official Comment

Prior Uniform Statutory Provision: On cumulation of warranties see Sections 14, 15, and 16, Uniform Sales Act.

Changes: Completely rewritten into one section.

Purposes of Changes: 1. The present section rests on the basic policy of this Article [Chapter] that no warranty is created except by some conduct (either affirmative action or failure to disclose) on the part of the seller. Therefore, all warranties are made cumulative unless this construction of the contract is impossible or unreasonable.

This Article [Chapter] thus follows the general policy of the Uniform Sales Act except that in case of the sale of an article by its patent or trade name the elimination of the warranty of fitness depends solely on whether the buyer has relied on the seller's skill and judgment; the use of the patent or trade name is but one factor in making this determination.

2. The rules of this section are designed to aid in determining the intention of the parties as to which of inconsistent warranties which have arisen from the circumstances of their transaction shall prevail. These rules of intention are to be applied only where factors making for an equitable estoppel of the seller do not exist and where he has in perfect good faith made warranties which later turn out to be inconsistent. To the extent that the seller has led the buyer to believe that all of the warranties can be performed, he is estopped from setting up any essential inconsistency as a defense.

3. The rules in subsections (a), (b) and (c) are designed to ascertain the intention of the parties by reference to the factor which probably claimed the attention of the parties in the first instance. These rules are not absolute but may be changed by evidence showing that the conditions which existed at the time of contracting make the construction called for by the section inconsistent or unreasonable.

Cross Reference: Point 1: Section 2-315.

Definitional Cross Reference: "Party." Section 1-201.

§ 28-2-318. Third party beneficiaries of warranties express or implied.

— A seller's warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

History.

1967, ch. 161, § 2-318, p. 351.

CASE NOTES

Corporate Employee.

Where the employee of a potential buyer was injured while test driving a vehicle, the employee was entitled to the protection of any warranties extended to the buyer by the manufacturers or seller; the employee was the third-party beneficiary of any warranties extended to the buyer under this section, and as an agent of the corporation, the employee was the "person" to whom the warranties were extended. Green v. A.B. Hagglund & Soner, 634 F. Supp. 790 (D. Idaho 1986).

An employee of a corporate purchaser, who could have reasonably been expected to have benefited from warranties given to that corporate purchaser, can maintain an action against the party making the warranties for claims of personal injuries allegedly resulting from a breach of those

warranties. Green v. A.B. Hagglund & Soner, 634 F. Supp. 790 (D. Idaho 1986).

Corporate Household.

The language used in this section to describe beneficiaries of express warranties does not encompass a "corporate household." Green v. A.B. Hagglund & Soner, 634 F. Supp. 790 (D. Idaho 1986).

Legislative Intent of Section.

The legislative intent of this section is to extend warranties to those who the buyer would have intended to benefit from the warranty. In the context of an individual buyer, that would be those persons in his family or a guest in his home; in the corporate context, that would include employees who would reasonably be expected to use the product. Green v. A.B. Hagglund & Soner, 634 F. Supp. 790 (D. Idaho 1986).

Driver and her passenger who collided with buyer's truck were not either "persons who were in the family or household" of the buyer or "a guest" in the buyer's home and, therefore, were not third party beneficiaries who could recover under a breach of an express warranty claim between used car dealer and buyer of truck which was involved in accident. Mugavero v. A-1 Auto Sales, Inc., 130 Idaho 554, 944 P.2d 151 (Ct. App. 1997).

Personal Injury Damages.

The UCC does provide for recovery of damages for personal injuries under its breach of warranty provisions. However, UCC breach of warranty actions for personal injuries are available to a limited group of potential plaintiffs who are either in privity of contract with the manufacturer or seller, or who qualify as third party beneficiaries of the underlying sales contract, as defined in this section. Oats v. Nissan Motor Corp., 126 Idaho 162, 879 P.2d 1095 (1994).

Privity of Contract.

Privity of contract is required in a contract action to recover economic loss for breach of implied warranty; breach of implied warranty actions for purely economic losses must be viewed in a contract setting with relevant contract principles. Adkison Corp. v. American Bldg. Co., 107 Idaho 406, 690 P.2d 341 (1984).

Statute of Limitations.

Where any warranties of merchantability were made between the defendant manufacturer and the purchaser, the plaintiff, as a seasonal employee of the purchaser, was a person to whom the warranties were extended, and the trial court properly granted defendants' motion for summary judgment as to plaintiff's warranty claim, filed 17 years after delivery. Puckett v. Oakfabco, Inc., 132 Idaho 816, 979 P.2d 1174 (1999).

Cited Luna v. Shockey Sheet Metal & Welding Co., 113 Idaho 193, 743 P.2d 61 (1987); Myers v. A.O. Smith Harvestore Prods., Inc., 114 Idaho 432, 757 P.2d 695 (Ct. App. 1988).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 625 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. The last sentence of this section does not mean that a seller is precluded from excluding or disclaiming a warranty which might otherwise arise in connection with the sale provided such exclusion or modification is permitted by Section 2-316. Nor does that sentence preclude the seller from limiting the remedies of his own buyer and of any beneficiaries, in any manner provided in Section 2-718 or 2-719. To the extent that the contract of sale contains provisions under which warranties are excluded or modified, or remedies for breach are limited, such provisions are equally operative against beneficiaries of warranties under this section. What this last sentence forbids is exclusion of liability by the seller to the persons to whom the warranties which he has made to his buyer would extend under this section.

2. The purpose of this section is to give certain beneficiaries the benefit of the same warranty which the buyer received in the contract of sale, thereby freeing any such beneficiaries from any technical rules as to "privity." It seeks to accomplish this purpose without any derogation of any right or remedy resting on negligence. It rests primarily upon the merchant-seller's warranty under this Article [Chapter] that the goods sold are

merchantable and fit for the ordinary purposes for which such goods are used rather than the warranty of fitness for a particular purpose. Implicit in the section is that any beneficiary of a warranty may bring a direct action for breach of warranty against the seller whose warranty extends to him.

3. This section expressly includes as beneficiaries within its provisions the family, household, and guests of the purchaser. Beyond this, the section in this form is neutral and is not intended to enlarge or restrict the developing case law on whether the seller's warranties, given to his buyer who resells, extend to other persons in the distributive chain.

Cross References: Point 1: Sections 2-316, 2-718 and 2-719.

Point 2: Section 2-314.

Definitional Cross References: "Buyer." Section 2-103.

"Goods." Section 2-105.

"Seller." Section 2-103.

§ 28-2-319. F.O.B. and F.A.S. terms. — (1) Unless otherwise agreed the term F.O.B. (which means "free on board") at a named place, even though used only in connection with the stated price, is a delivery term under which

(a) when the term is F.O.B. the place of shipment, the seller must at that place ship the goods in the manner provided in this chapter (section 28-2-504[, Idaho Code]) and bear the expense and risk of putting them into the possession of the carrier; or (b) when the term is F.O.B. the place of destination, the seller must at his own expense and risk transport the goods to that place and there tender delivery of them in the manner provided in this chapter (section 28-2-503[, Idaho Code]); (c) when under either (a) or (b) the term is also F.O.B. vessel, car or other vehicle, the seller must in addition at his own expense and risk load the goods on board. If the term is F.O.B. vessel the buyer must name the vessel and in an appropriate case the seller must comply with the provisions of this chapter on the form of bill of lading (section 28-2-323[, Idaho Code]).

(2) Unless otherwise agreed the term F.A.S. vessel (which means "free alongside") at a named port, even though used only in connection with the stated price, is a delivery term under which the seller must (a) at his own expense and risk deliver the goods alongside the vessel in the manner usual in that port or on a dock designated and provided by the buyer; and (b) obtain and tender a receipt for the goods in exchange for which the carrier is under a duty to issue a bill of lading.

(3) Unless otherwise agreed in any case falling within subsection (1)(a) or (c) or subsection (2) the buyer must seasonably give any needed instructions for making delivery, including when the term is F.A.S. or F.O.B. the loading berth of the vessel and in an appropriate case its name and sailing date. The seller may treat the failure of needed instructions as a failure of cooperation under this chapter (section 28-2-311[, Idaho Code]). He may also at his option move the goods in any reasonable manner preparatory to delivery or shipment.

(4) Under the term F.O.B. vessel or F.A.S. unless otherwise agreed the buyer must make payment against tender of the required documents and the

seller may not tender nor the buyer demand delivery of the goods in substitution for the documents.

History.

1967, ch. 161, § 2-319, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in paragraphs (1)(a), (1)(b), and (1)(c) and subsection (3) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appears in the law as enacted.

CASE NOTES

Cited In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 515 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. This section is intended to negate the uncommercial line of decision which treats an "F.O.B." term as "merely a price term." The distinctions taken in subsection (1) handle most of the issues which have on occasion led to the unfortunate judicial language just referred to. Other matters which have led to sound results being based on unhappy language in regard to F.O.B. clauses are dealt with in this Act by Section 2-311 (2) (seller's option arrangements relating to shipment) and Sections 2-614 and 615 (substituted performance and seller's excuse).

2. Subsection (1) (c) not only specifies the duties of a seller who engages to deliver "F.O.B. vessel," or the like, but ought to make clear that no

agreement is soundly drawn when it looks to reshipment from San Francisco or New York, but speaks merely of "F.O.B." the place.

3. The buyer's obligations stated in subsection (1) (c) and subsection (3) are, as shown in the text, obligations of cooperation. The last sentence of subsection (3) expressly, though perhaps unnecessarily, authorizes the seller, pending instructions, to go ahead with such preparatory moves as shipment from the interior to the named point of delivery. The sentence presupposes the usual case in which instructions "fail"; a prior repudiation by the buyer, giving notice that breach was intended, would remove the reason for the sentence, and would normally bring into play, instead, the second sentence of Section 2-704, which duly calls for lessening damages.

4. The treatment of "F.O.B. vessel" in conjunction with F.A.S. fits, in regard to the need for payment against documents, with standard practice and caselaw; but "F.O.B. vessel" is a term which by its very language makes express the need for an "on board" document. In this respect, that term is stricter than the ordinary overseas "shipment" contract (C.I.F., etc., Section 2-320).

Cross References: Sections 2-311(3), 2-323, 2-503 and 2-504.

Definitional Cross References: "Agreed." Section 1-201.

"Bill of lading." Section 1-201.

"Buyer." Section 2-103.

"Goods." Section 2-105.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

"Term." Section 1-201.

§ 28-2-320. C.I.F. and C. & F. terms. — (1) The term C.I.F. means that the price includes in a lump sum the cost of the goods and the insurance and freight to the named destination. The term C. & F. or C.F. means that the price so includes cost and freight to the named destination.

(2) Unless otherwise agreed and even though used only in connection with the stated price and destination, the term C.I.F. destination or its equivalent requires the seller at his own expense and risk to

(a) put the goods into the possession of a carrier at the port for shipment and obtain a negotiable bill or bills of lading covering the entire transportation to the named destination; and

(b) load the goods and obtain a receipt from the carrier (which may be contained in the bill of lading) showing that the freight has been paid or provided for; and

(c) obtain a policy or certificate of insurance, including any war risk insurance, of a kind and on terms then current at the port of shipment in the usual amount, in the currency of the contract, shown to cover the same goods covered by the bill of lading and providing for payment of loss to the order of the buyer or for the account of whom it may concern; but the seller may add to the price the amount of the premium for any such war risk insurance; and

(d) prepare an invoice of the goods and procure any other documents required to effect shipment or to comply with the contract; and

(e) forward and tender with commercial promptness all the documents in due form and with any indorsement necessary to perfect the buyer's rights.

(3) Unless otherwise agreed the term C. & F. or its equivalent has the same effect and imposes upon the seller the same obligations and risks as a C.I.F. term except the obligation as to insurance.

(4) Under the term C.I.F. or C. & F. unless otherwise agreed the buyer must make payment against tender of the required documents and the seller

may not tender nor the buyer demand delivery of the goods in substitution for the documents.

History.

1967, ch. 161, § 2-320, p. 351.

STATUTORY NOTES

Compiler's Notes.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Cited In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 515 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: To make it clear that:

1. The C.I.F. contract is not a destination but a shipment contract with risk of subsequent loss or damage to the goods passing to the buyer upon shipment if the seller has properly performed all his obligations with respect to the goods. Delivery to the carrier is delivery to the buyer for purposes of risk and "title." Delivery of possession of the goods is accomplished by delivery of the bill of lading, and upon tender of the required documents the buyer must pay the agreed price without awaiting the arrival of the goods and if they have been lost or damaged after proper shipment he must seek his remedy against the carrier or insurer. The buyer has no right of inspection prior to payment or acceptance of the documents.

2. The seller's obligations remain the same even though the C.I.F. term is "used only in connection with the stated price and destination."

3. The insurance stipulated by the C.I.F. term is for the buyer's benefit, to protect him against the risk of loss or damage to the goods in transit. A clause in a C.I.F. contract "insurance — for the account of sellers" should be viewed in its ordinary mercantile meaning that the sellers must pay for the insurance and not that it is intended to run to the seller's benefit.

4. A bill of lading covering the entire transportation from the port of shipment is explicitly required but the provision on this point must be read in the light of its reason to assure the buyer of as full protection as the conditions of shipment reasonably permit, remembering always that this type of contract is designed to move the goods in the channels commercially available. To enable the buyer to deal with the goods while they are afloat the bill of lading must be one that covers only the quantity of goods called for by the contract. The buyer is not required to accept his part of the goods without a bill of lading because the latter covers a larger quantity, nor is he required to accept a bill of lading for the whole quantity under a stipulation to hold the excess for the owner. Although the buyer is not compelled to accept either goods or documents under such circumstances he may of course claim his rights in any goods which have been identified to his contract.

5. The seller is given the option of paying or providing for the payment of freight. He has no option to ship "freight collect" unless the agreement so provides. The rule of the common law that the buyer need not pay the freight if the goods do not arrive is preserved.

Unless the shipment has been sent "freight collect" the buyer is entitled to receive documentary evidence that he is not obligated to pay the freight; the seller is therefore required to obtain a receipt "showing that the freight has been paid or provided for." The usual notation on the bill of lading that the freight has been prepaid is a sufficient receipt, as at common law. The phrase "provided for" is intended to cover the frequent situation in which the carrier extends credit to a shipper for the freight on successive shipments and receives periodical payments of the accrued freight charges from him.

6. The requirement that unless otherwise agreed the seller must procure insurance "of a kind and on terms then current at the port for shipment in the usual amount, in the currency of the contract, sufficiently shown to

cover the same goods covered by the bill of lading", applies to both marine and war risk insurance. As applied to marine insurance, it means such insurance as is usual or customary at the port for shipment with reference to the particular kind of goods involved, the character and equipment of the vessel, the route of the voyage, the port of destination and any other considerations that affect the risk. It is the substantial equivalent of the ordinary insurance in the particular trade and on the particular voyage and is subject to agreed specifications of type or extent of coverage. The language does not mean that the insurance must be adequate to cover all risks to which the goods may be subject in transit. There are some types of loss or damage that are not covered by the usual marine insurance and are excepted in bills of lading or in applicable statutes from the causes of loss or damage for which the carrier or the vessel is liable. Such risks must be borne by the buyer under this Article [Chapter].

Insurance secured in compliance with a C.I.F. term must cover the entire transportation of the goods to the named destination.

7. An additional obligation is imposed upon the seller in requiring him to procure customary war risk insurance at the buyer's expense. This changes the common law on the point. The seller is not required to assume the risk of including in the C.I.F. price the cost of such insurance, since it often fluctuates rapidly, but is required to treat it simply as a necessary for the buyer's account. What war risk insurance is "current" or usual turns on the standard forms of policy or rider in common use.

8. The C.I.F. contract calls for insurance covering the value of the goods at the time and place of shipment and does not include any increase in market value during transit or any anticipated profit to the buyer on a sale by him.

The contract contemplates that before the goods arrive at their destination they may be sold again and again on C.I.F. terms and that the original policy of insurance and bill of lading will run with the interest in the goods by being transferred to each successive buyer. A buyer who becomes the seller in such an intermediate contract for sale does not thereby, if his sub-buyer knows the circumstances, undertake to insure the goods again at an increased price fixed in the new contract or to cover the increase in price by additional insurance, and his buyer may not reject the documents on the

ground that the original policy does not cover such higher price. If such a sub-buyer desires additional insurance he must procure it for himself.

Where the seller exercises an option to ship “freight collect” and to credit the buyer with the freight against the C.I.F. price, the insurance need not cover the freight since the freight is not at the buyer’s risk. On the other hand, where the seller prepays the freight upon shipping under a bill of lading requiring prepayment and providing that the freight shall be deemed earned and shall be retained by the carrier “ship and/or cargo lost or not lost,” or using words of similar import, he must procure insurance that will cover the freight, because notwithstanding that the goods are lost in transit the buyer is bound to pay the freight as part of the C.I.F. price and will be unable to recover it back from the carrier.

9. Insurance “for the account of whom it may concern” is usual and sufficient. However, for a valid tender the policy of insurance must be one which can be disposed of together with the bill of lading and so must be “sufficiently shown to cover the same goods covered by the bill of lading.” It must cover separately the quantity of goods called for by the buyer’s contract and not merely insure his goods as part of a larger quantity in which others are interested, a case provided for in American mercantile practice by the use of negotiable certificates of insurance which are expressly authorized by this section. By usage these certificates are treated as the equivalent of separate policies and are good tender under C.I.F. contracts. The term “certificate of insurance,” however, does not of itself include certificates or “cover notes” issued by the insurance broker and stating that the goods are covered by a policy. Their sufficiency as substitutes for policies will depend upon proof of an established usage or course of dealing. The present section rejects the English rule that not only brokers’ certificates and “cover notes” but also certain forms of American insurance certificates are not the equivalent of policies and are not good tender under a C.I.F. contract.

The seller’s failure to tender a proper insurance document is waived if the buyer refuses to make payment on other and untenable grounds at a time when proper insurance could have been obtained and tendered by the seller if timely objection had been made. Even a failure to insure on shipment may be cured by seasonable tender of a policy retroactive in effect; e.g., one insuring the goods “lost or not lost.” The provisions of this Article

[Chapter] on cure of improper tender and on waiver of buyer's objections by silence are applicable to insurance tenders under a C.I.F. term. Where there is no waiver by the buyer as described above, however, the fact that the goods arrive safely does not cure the seller's breach of his obligations to insure them and tender to the buyer a proper insurance document.

10. The seller's invoice of the goods shipped under a C.I.F. contract is regarded as a usual and necessary document upon which reliance may properly be placed. It is the document which evidences points of description, quality and the like which do not readily appear in other documents. This Article [Chapter] rejects those statements to the effect that the invoice is a usual but not a necessary document under a C.I.F. term.

11. The buyer needs all of the documents required under a C.I.F. contract, in due form and, if a tangible document of title, with necessary endorsements, so that before the goods arrive he may deal with them by negotiating the documents or may obtain prompt possession of the goods after their arrival. If the goods are lost or damaged in transit the documents are necessary to enable him promptly to assert his remedy against the carrier or insurer. The seller is therefore obligated to do what is mercantilely reasonable in the circumstances and should make every reasonable exertion to send forward the documents as soon as possible after the shipment. The requirement that the documents be forwarded with "commercial promptness" expresses a more urgent need for action than that suggested by the phrase "reasonable time."

12. Under a C.I.F. contract the buyer, as under the common law, must pay the price upon tender of the required documents without first inspecting the goods, but his payment in these circumstances does not constitute an acceptance of the goods nor does it impair his right of subsequent inspection or his options and remedies in the case of improper delivery. All remedies and rights for the seller's breach are reserved to him. The buyer must pay before inspection and assert his remedy against the seller afterward unless the nonconformity of the goods amounts to a real failure of consideration, since the purpose of choosing this form of contract is to give the seller protection against the buyer's unjustifiable rejection of the goods at a distant port of destination which would necessitate taking possession of the goods and suing the buyer there.

13. A valid C.I.F. contract may be made which requires part of the transportation to be made on land and part on the sea, as where the goods are to be brought by rail from an inland point to a seaport and thence transported by vessel to the named destination under a “through” or combination bill of lading issued by the railroad company. In such a case shipment by rail from the inland point within the contract period is a timely shipment notwithstanding that the loading of the goods on the vessel is delayed by causes beyond the seller’s control.

14. Although subsection (2) stating the legal effects of the C.I.F. term is an “unless otherwise agreed” provision, the express language used in an agreement is frequently a precautionary, fuller statement of the normal C.I.F. terms and hence not intended as a departure or variation from them. Moreover, the dominant outlines of the C.I.F. term are so well understood commercially that any variation should, whenever reasonably possible, be read as falling within those dominant outlines rather than as destroying the whole meaning of a term which essentially indicates a contract for proper shipment rather than one for delivery at destination. Particularly careful consideration is necessary before a printed form or clause is construed to mean agreement otherwise and where a C.I.F. contract is prepared on a printed form designed for some other type of contract, the C.I.F. terms must prevail over printed clauses repugnant to them.

15. Under subsection (4) the fact that the seller knows at the time of the tender of the documents that the goods have been lost in transit does not affect his rights if he has performed his contractual obligations. Similarly, the seller cannot perform under a C.I.F. term by purchasing and tendering landed goods.

16. Under the C. & F. term, as under the C.I.F. term, title and risk of loss are intended to pass to the buyer on shipment. A stipulation in a C. & F. contract that the seller shall effect insurance on the goods and charge the buyer with the premium (in effect that he shall act as the buyer’s agent for that purpose) is entirely in keeping with the pattern. On the other hand, it often happens that the buyer is in a more advantageous position than the seller to effect insurance on the goods or that he has in force an “open” or “floating” policy covering all shipments made by him or to him, in either of which events the C. & F. term is adequate without mention of insurance.

17. It is to be remembered that in a French contract the term "C.A.F." does not mean "Cost and Freight" but has exactly the same meaning as the term "C.I.F." since it is merely the French equivalent of that term. The "A" does not stand for "and" but for "assurance" which means insurance.

Cross References: Point 4: Section 2-323.

Point 6: Section 2-509 (1) (a).

Point 9: Sections 2-508 and 2-605 (1) (a).

Point 12: Sections 2-321 (3), 2-512 and 2-513 (3) and Article [Chapter] 5.

Definitional Cross References: "Bill of lading." Section 1-201.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Rights." Section 1-201.

"Seller." Section 2-103.

"Term." Section 1-201.

§ 28-2-321. C.I.F. or C. & F. — "Net landed weights" — "Payment on arrival" — Warranty of condition on arrival. — Under a contract containing a term C.I.F. or C. & F.

(1) Where the price is based on or is to be adjusted according to "net landed weights," "delivered weights," "out turn" quantity or quality or the like, unless otherwise agreed the seller must reasonably estimate the price. The payment due on tender of the documents called for by the contract is the amount so estimated, but after final adjustment of the price a settlement must be made with commercial promptness.

(2) An agreement described in subsection (1) or any warranty of quality or condition of the goods on arrival places upon the seller the risk of ordinary deterioration, shrinkage and the like in transportation but has no effect on the place or time of identification to the contract for sale or delivery or on the passing of the risk of loss.

(3) Unless otherwise agreed where the contract provides for payment on or after arrival of the goods the seller must before payment allow such preliminary inspection as is feasible; but if the goods are lost delivery of the documents and payment are due when the goods should have arrived.

History.

1967, ch. 161, § 2-321, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 515 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: This section deals with two variations of the C.I.F. contract which have evolved in mercantile practice but are entirely consistent with the basic C.I.F. pattern. Subsections (1) and (2), which provide for a shift to the seller of the risk of quality and weight deterioration during shipment, are designed to conform the law to the best mercantile practice and usage

without changing the legal consequences of the C.I.F. or C. & F. term as to the passing of marine risks to the buyer at the point of shipment. Subsection (3) provides that where under the contract documents are to be presented for payment after arrival of the goods, this amounts merely to a postponement of the payment under the C.I.F. contract and is not to be confused with the "no arrival, no sale" contract. If the goods are lost, delivery of the documents and payment against them are due when the goods should have arrived. The clause for payment on or after arrival is not to be construed as such a condition precedent to payment that if the goods are lost in transit the buyer need never pay and the seller must bear the loss.

Cross Reference: Section 2-324.

Definitional Cross References: "Agreement." Section 1-201.

"Contract." Section 1-201.

"Delivery." Section 1-201.

"Goods." Section 2-105.

"Seller." Section 2-103.

"Term." Section 1-201.

§ 28-2-322. Delivery "ex-ship." — (1) Unless otherwise agreed a term for delivery of goods "ex-ship" (which means from the carrying vessel) or in equivalent language is not restricted to a particular ship and requires delivery from a ship which has reached a place at the named port of destination where goods of the kind are usually discharged.

(2) Under such a term unless otherwise agreed (a) the seller must discharge all liens arising out of the carriage and furnish the buyer with a direction which puts the carrier under a duty to deliver the goods; and (b) the risk of loss does not pass to the buyer until the goods leave the ship's tackle or are otherwise properly unloaded.

History.

1967, ch. 161, § 2-322, p. 351.

STATUTORY NOTES

Compiler's Notes.

The words enclosed in parentheses so appeared in the law as enacted.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 520.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. The delivery term, "ex-ship," as between seller and buyer, is the reverse of the f.a.s. term covered.

2. Delivery need not be made from any particular vessel under a clause calling for delivery "ex-ship," even though a vessel on which shipment is to be made originally is named in the contract, unless the agreement by appropriate language, restricts the clause to delivery from a named vessel.

3. The appropriate place and manner of unloading at the port of destination depend upon the nature of the goods and the facilities and usages of the port.

4. A contract fixing a price "ex-ship" with payment "cash against documents" calls only for such documents as are appropriate to the contract. Tender of a delivery order and of a receipt for the freight after the arrival of the carrying vessel is adequate. The seller is not required to tender a bill of lading as a document of title nor is he required to insure the goods for the buyer's benefit, as the goods are not at the buyer's risk during the voyage.

Cross Reference: Point 1: Section 2-319 (2).

Definitional Cross References: "Buyer." Section 2-103.

"Goods." Section 2-105.

"Seller." Section 2-103.

"Term." Section 1-201.

§ 28-2-323. Form of bill of lading required in overseas shipment — "Overseas." — (1) Where the contract contemplates overseas shipment and contains a term C.I.F. or C. & F. or F.O.B. vessel, the seller unless otherwise agreed must obtain a negotiable bill of lading stating that the goods have been loaded on board or, in the case of a term C.I.F. or C. & F., received for shipment.

(2) Where in a case within subsection (1) of this section a tangible bill of lading has been issued in a set of parts, unless otherwise agreed if the documents are not to be sent from abroad the buyer may demand tender of the full set; otherwise only one (1) part of the bill of lading need be tendered. Even if the agreement expressly requires a full set (a) due tender of a single part is acceptable within the provisions of this chapter on cure of improper delivery (subsection (1) of section 28-2-508[, Idaho Code]); and (b) even though the full set is demanded, if the documents are sent from abroad the person tendering an incomplete set may nevertheless require payment upon furnishing an indemnity which the buyer in good faith deems adequate.

(3) A shipment by water or by air or a contract contemplating such shipment is "overseas" insofar as by usage of trade or agreement it is subject to the commercial, financing or shipping practices characteristic of international deep water commerce.

History.

1967, ch. 161, § 2-323, p. 351; am. 2004, ch. 42, § 7, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in paragraph (2)(a) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 507 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) follows the "American" rule that a regular bill of lading indicating delivery of the goods at the dock for shipment is sufficient, except under a term "F.O.B. vessel." See Section 2-319 and comment thereto.

2. Subsection (2) deals with the problem of bills of lading covering deep water shipments, issued not as a single bill of lading but in a set of parts, each part referring to the other parts and the entire set constituting in commercial practice and at law a single bill of lading. Commercial practice in international commerce is to accept and pay against presentation of the first part of a set if the part is sent from overseas even though the contract of the buyer requires presentation of a full set of bills of lading provided adequate indemnity for the missing parts is forthcoming. In accord with the amendment to Section 7-304, bills of lading in a set are limited to tangible bills.

This subsection codifies that practice as between buyer and seller. Article [Chapter] 5 (Section 5-113) authorizes banks presenting drafts under letters of credit to give indemnities against the missing parts, and this subsection means that the buyer must accept and act on such indemnities if he in good faith deems them adequate. But neither this subsection nor Article [Chapter] 5 decides whether a bank which has issued a letter of credit is similarly bound. The issuing bank's obligation under a letter of credit is independent and depends on its own terms. See Article [Chapter] 5.

Cross References: Sections 2-508 (2), 5-113.

Definitional Cross References: "Bill of lading." Section 1-201.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Delivery." Section 1-201.

"Financing agency." Section 2-104.

"Person." Section 1-201.

"Seller." Section 2-103.

"Send." Section 1-201.

"Term." Section 1-201.

§ 28-2-324. "No arrival, no sale" term. — Under a term "no arrival, no sale" or terms of like meaning, unless otherwise agreed,

(a) the seller must properly ship conforming goods and if they arrive by any means he must tender them on arrival but he assumes no obligation that the goods will arrive unless he has caused the nonarrival; and (b) where without fault of the seller the goods are in part lost or have so deteriorated as no longer to conform to the contract or arrive after the contract time, the buyer may proceed as if there had been casualty to identified goods (section 28-2-613[, Idaho Code]).

History.

1967, ch. 161, § 2-324, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion at the end of subsection (b) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 522.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. The "no arrival, no sale" term in a "destination" overseas contract leaves risk of loss on the seller but gives him an exemption from liability for nondelivery. Both the nature of the case and the duty of good faith require that the seller must not interfere with the arrival of the goods in any way. If the circumstances impose upon him the responsibility for making or arranging the shipment, he must have a shipment made despite the exemption clause. Further, the shipment made must be a conforming

one, for the exemption under a “no arrival, no sale” term applies only to the hazards of transportation and the goods must be proper in all other respects.

The reason of this section is that where the seller is reselling goods bought by him as shipped by another and this fact is known to the buyer, so that the seller is not under any obligation to make the shipment himself, the seller is entitled under the “no arrival, no sale” clause to exemption from payment of damages for nondelivery if the goods do not arrive or if the goods which actually arrive are nonconforming. This does not extend to sellers who arrange shipment by their own agents, in which case the clause is limited to casualty due to marine hazards. But sellers who make known that they are contracting only with respect to what will be delivered to them by parties over whom they assume no control are entitled to the full quantum of the exemption.

2. The provisions of this Article [Chapter] on identification must be read together with the present section in order to bring the exemption into application. Until there is some designation of the goods in a particular shipment or on a particular ship as being those to which the contract refers there can be no application of an exemption for their nonarrival.

3. The seller’s duty to tender the agreed or declared goods if they do arrive is not impaired because of their delay in arrival or by their arrival after transshipment.

4. The phrase “to arrive” is often employed in the same sense as “no arrival, no sale” and may then be given the same effect. But a “to arrive” term, added to a C.I.F. or C. & F. contract, does not have the full meaning given by this section to “no arrival, no sale.” Such a “to arrive” term is usually intended to operate only to the extent that the risks are not covered by the agreed insurance and the loss or casualty is due to such uncovered hazards. In some instances the “to arrive” term may be regarded as a time of payment term, or, in the case of the reselling seller discussed in point 1 above, as negating responsibility for conformity of the goods, if they arrive, to any description which was based on his good faith belief of the quality. Whether this is the intention of the parties is a question of fact based on all the circumstances surrounding the resale and in case of ambiguity the rules of Sections 2-316 and 2-317 apply to preclude dishonor.

5. Paragraph (b) applies where goods arrive impaired by damage or partial loss during transportation and makes the policy of this Article [Chapter] on casualty to identified goods applicable to such a situation. For the term cannot be regarded as intending to give the seller an unforeseen profit through casualty; it is intended only to protect him from loss due to causes beyond his control.

Cross References: Point 1: Section 1-203.

Point 2: Section 2-501 (a) and (c).

Point 5: Section 2-613.

Definitional Cross References: "Buyer." Section 2-103.

"Conforming." Section 2-106.

"Contract." Section 1-201.

"Fault." Section 1-201.

"Goods." Section 2-105.

"Sale." Section 2-106.

"Seller." Section 2-103.

"Term." Section 1-201.

§ 28-2-325. "Letter of credit" term — "Confirmed credit." — (1) Failure of the buyer seasonably to furnish an agreed letter of credit is a breach of the contract for sale.

(2) The delivery to seller of a proper letter of credit suspends the buyer's obligation to pay. If the letter of credit is dishonored, the seller may on seasonable notification to the buyer require payment directly from him.

(3) Unless otherwise agreed the term "letter of credit" or "banker's credit" in a contract for sale means an irrevocable credit issued by a financing agency of good repute and, where the shipment is overseas, of good international repute. The term "confirmed credit" means that the credit must also carry the direct obligation of such an agency which does business in the seller's financial market.

History.

1967, ch. 161, § 2-325, p. 351.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: To express the established commercial and banking understanding as to the meaning and effects of terms calling for "letters of credit" or "confirmed credit": 1. Subsection (2) follows the general policy of this Article [Chapter] and Article [Chapter] 3 (Section 3-802) on conditional payment, under which payment by check or other short-term instrument is not ordinarily final as between the parties if the recipient duly presents the instrument and honor is refused. Thus the furnishing of a letter of credit does not substitute the financing agency's obligation for the buyer's, but the seller must first give the buyer reasonable notice of his intention to demand direct payment from him.

2. Subsection (3) requires that the credit be irrevocable and be a prime credit as determined by the standing of the issuer. It is not necessary, unless otherwise agreed, that the credit be a negotiation credit; the seller can finance himself by an assignment of the proceeds under Section 5-116 (2).

3. The definition of "confirmed credit" is drawn on the supposition that the credit is issued by a bank which is not doing direct business in the seller's financial market; there is no intention to require the obligation of two banks both local to the seller.

Cross References: Sections 2-403, 2-511 (3) and 3-802 and Article [Chapter] 5.

Definitional Cross References: "Buyer." Section 2-103.

"Contract for sale." Section 2-106.

"Draft." Section 3-104.

"Financing agency." Section 2-104.

"Notifies." Section 1-201.

"Overseas." Section 2-323.

"Purchaser." Section 1-201.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

"Term." Section 1-201.

§ 28-2-326. Sale on approval and sale or return — Rights of creditors.

— (1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is:

(a) A "sale on approval" if the goods are delivered primarily for use; and
(b) A "sale or return" if the goods are delivered primarily for resale.

(2) Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this chapter (section 28-2-201[, Idaho Code]) and as contradicting the sale aspect of the contract within the provisions of this chapter on parol or extrinsic evidence (section 28-2-202[, Idaho Code]).

History.

1967, ch. 161, § 2-326, p. 351; am. 2001, ch. 208, § 7, p. 704.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (3) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 434 et seq.

68A Am. Jur. 2d, Secured Transactions, § 1 et seq.

ALR. — "Sale on approval" and "sale or return" contracts under Uniform Commercial Code § 2-326. 44 A.L.R.6th 441.

Official Comment

Prior Uniform Statutory Provision: Section 19 (3), Uniform Sales Act.

Changes: Completely rewritten in this and the succeeding section.

Purposes of Changes: To make it clear that: 1. A "sale on approval" or "sale or return" is distinct from other types of transactions with which they have frequently been confused. The type of "sale on approval," "on trial" or "on satisfaction" dealt with involves a contract under which the seller undertakes a particular business risk to satisfy his prospective buyer with the appearance or performance of the goods in question. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them. The price has already been agreed. The buyer's willingness to receive and test the goods is the consideration for the seller's engagement to deliver and sell. The type of "sale or return" involved herein is a sale to a merchant whose unwillingness to buy is overcome only by the seller's engagement to take back the goods (or any commercial unit of goods) in lieu of payment if they fail to be resold. These two transactions are so strongly delineated in practice and in general understanding that every presumption runs against a delivery to a consumer being a "sale or return" and against a delivery to a merchant for resale being a "sale on approval."

The right to return the goods for failure to conform to the contract does not make the transaction a "sale on approval" or "sale or return" and has nothing to do with this and the following section. The present section is not concerned with remedies for breach of contract. It deals instead with a power given by the contract to turn back the goods even though they are wholly as warranted.

This section nevertheless presupposes that a contract for sale is contemplated by the parties although that contract may be of the peculiar character here described.

Where the buyer's obligation as a buyer is conditioned not on his personal approval but on the article's passing a described objective test, the

risk of loss by casualty pending the test is properly the seller's and proper return is at his expense. On the point of "satisfaction" as meaning "reasonable satisfaction" where an industrial machine is involved, this Article [Chapter] takes no position.

2. Pursuant to the general policies of this Act which require good faith not only between the parties to the sales contract, but as against interested third parties, subsection (3) resolves all reasonable doubts as to the nature of the transaction in favor of the general creditors of the buyer. As against such creditors words such as "on consignment" or "on memorandum," with or without words of reservation of title in the seller, are disregarded when the buyer has a place of business at which he deals in goods of the kind involved. A necessary exception is made where the buyer is known to be engaged primarily in selling the goods of others or is selling under a relevant sign law, or the seller complies with the filing provisions of Article [Chapter] 9 as if his interest were a security interest. However, there is no intent in this Section to narrow the protection afforded to third parties in any jurisdiction which has a selling Factors Act. The purpose of the exception is merely to limit the effect of the present subsection itself, in the absence of any such Factors Act, to cases in which creditors of the buyer may reasonably be deemed to have been misled by the secret reservation.

3. Subsection (4) resolves a conflict in the pre-existing case law by recognition that an "or return" provision is so definitely at odds with any ordinary contract for sale of goods that where written agreements are involved it must be contained in a written memorandum. The "or return" aspect of a sales contract must be treated as a separate contract under the Statute of Frauds section and as contradicting the sale insofar as questions of parol or extrinsic evidence are concerned.

Cross References: Point 2: Article [Chapter] 9.

Point 3: Sections 2-201 and 2-202.

Definitional Cross References: "Between merchants." Section 2-104.

"Buyer." Section 2-103.

"Conform." Section 2-106.

"Contract for sale." Section 2-106.

"Creditor." Section 1-201.

"Goods." Section 2-105.

"Sale." Section 2-106.

"Seller." Section 2-103.

§ 28-2-327. Special incidents of sale on approval and sale or return. —
(1) Under a sale on approval unless otherwise agreed

(a) although the goods are identified to the contract the risk of loss and the title do not pass to the buyer until acceptance; and (b) use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole; and (c) after due notification of election to return, the return is at the seller's risk and expense but a merchant buyer must follow any reasonable instructions.

(2) Under a sale or return unless otherwise agreed (a) the option to return extends to the whole or any commercial unit of the goods while in substantially their original condition, but must be exercised seasonably; and (b) the return is at the buyer's risk and expense.

History.

1967, ch. 161, § 2-327, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 434 et seq.

ALR. — Goods in "sale or return" transaction under UCC § 2-327, 66 A.L.R.3d 190.

Official Comment

Prior Uniform Statutory Provision: Section 19 (3), Uniform Sales Act.

Changes: Completely rewritten in preceding and this section.

Purposes of Changes: To make it clear that: 1. In the case of a sale on approval: If all of the goods involved conform to the contract, the buyer's acceptance of part of the goods constitutes acceptance of the whole. Acceptance of part falls outside the normal intent of the parties in the "on approval" situation and the policy of this Article [Chapter] allowing partial

acceptance of a defective delivery has no application here. A case where a buyer takes home two dresses to select one commonly involves two distinct contracts; if not, it is covered by the words "unless otherwise agreed."

2. In the case of a sale or return, the return of any unsold unit merely because it is unsold is the normal intent of the "sale or return" provision, and therefore the right to return for this reason alone is independent of any other action under the contract which would turn on wholly different considerations. On the other hand, where the return of goods is for breach, including return of items resold by the buyer and returned by the ultimate purchasers because of defects, the return procedure is governed not by the present section but by the provisions on the effects and revocation of acceptance.

3. In the case of a sale on approval the risk rests on the seller until acceptance of the goods by the buyer, while in a sale or return the risk remains throughout on the buyer.

4. Notice of election to return given by the buyer in a sale on approval is sufficient to relieve him of any further liability. Actual return by the buyer to the seller is required in the case of a sale or return contract. What constitutes due "giving" of notice, as required in "on approval" sales, is governed by the provisions on good faith and notice. "Seasonable" is used here as defined in Section 1-204 [1-205]. Nevertheless, the provisions of both this Article [Chapter] and of the contract on this point must be read with commercial reason and with full attention to good faith.

Cross References: Point 1: Sections 2-501, 2-601 and 2-603.

Point 2: Sections 2-607 and 2-608.

Point 4: Sections 1-201 and 1-204 [1-205].

Definitional Cross References: "Agreed." Section 1-201.

"Buyer." Section 2-103.

"Commercial unit." Section 2-105.

"Conform." Section 2-106.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Merchant." Section 2-104.

"Notifies." Section 1-201.

"Notification." Section 1-201.

"Sale on approval." Section 2-326.

"Sale or return." Section 2-326.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

§ 28-2-328. Sale by auction. — (1) In a sale by auction if goods are put up in lots each lot is the subject of a separate sale.

(2) A sale by auction is complete when the auctioneer so announces by the fall of the hammer or in other customary manner. Where a bid is made while the hammer is falling in acceptance of a prior bid the auctioneer may in his discretion reopen the bidding or declare the goods sold under the bid on which the hammer was falling.

(3) Such a sale is with reserve unless the goods are in explicit terms put up without reserve. In an auction with reserve the auctioneer may withdraw the goods at any time until he announces completion of the sale. In an auction without reserve, after the auctioneer calls for bids on an article or lot, that article or lot cannot be withdrawn unless no bid is made within a reasonable time. In either case a bidder may retract his bid until the auctioneer's announcement of completion of the sale, but a bidder's retraction does not revive any previous bid.

(4) If the auctioneer knowingly receives a bid on the seller's behalf or the seller makes or procures such a bid, and notice has not been given that liberty for such bidding is reserved, the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid prior to the completion of the sale. This subsection shall not apply to any bid at a forced sale.

History.

1967, ch. 161, § 2-328, p. 351.

CASE NOTES

Authority of Auctioneer.

An auctioneer who believed that he had no power to refuse to accept a bid which was below a stated minimum, whose standard operating procedure was to refuse to sell items on which a minimum bid was set, and who believed that once a legitimate bid was received he was bound to accept it, was operating under a mistake of law. Hatfield v. Max Rouse &

Sons N.W., 100 Idaho 840, 606 P.2d 944 (1980), overruled on other grounds, Cheney v. Palos Verdes Inv. Corp., 104 Idaho 897, 665 P.2d 661 (1983).

Decisions Under Prior Law Right of seller to bid.

Right to purchase.

Right of Seller to Bid.

Seller must reserve right to purchase in notice of sale in order to become bona fide purchaser. Cranston v. Western Idaho Lumber & Bldg. Co., 41 Idaho 141, 238 P. 528 (1925).

Right to Purchase.

Holder of title retaining notes, who repossessed property, because of default in payment of purchase price, could not be purchaser of property at public sale unless notice of sale set out a reservation of right to purchase. Cranston v. Western Idaho Lumber & Bldg. Co., 41 Idaho 141, 238 P. 528 (1925).

Official Comment

Prior Uniform Statutory Provision: Section 21, Uniform Sales Act.

Changes: Completely rewritten.

Purposes of Changes: To make it clear that: 1. The auctioneer may in his discretion either reopen the bidding or close the sale on the bid on which the hammer was falling when a bid is made at that moment. The recognition of a bid of this kind by the auctioneer in his discretion does not mean a closing in favor of such a bidder, but only that the bid has been accepted as a continuation of the bidding. If recognized, such a bid discharges the bid on which the hammer was falling when it was made.

2. An auction "with reserve" is the normal procedure. The crucial point, however, for determining the nature of an auction is the "putting up" of the goods. This Article [Chapter] accepts the view that the goods may be withdrawn before they are actually "put up," regardless of whether the auction is advertised as one without reserve, without liability on the part of the auction announcer to persons who are present. This is subject to any

peculiar facts which might bring the case within the "firm offer" principle of this Article [Chapter], but an offer to persons generally would require unmistakable language in order to fall within that section. The prior announcement of the nature of the auction either as with reserve or without reserve will, however, enter as an "explicit term" in the "putting up" of the goods and conduct thereafter must be governed accordingly. The present section continues the prior rule permitting withdrawal of bids in auctions both with and without reserve; and the rule is made explicit that the retraction of a bid does not revive a prior bid.

Cross Reference: Point 2: Section 2-205.

Definitional Cross References: "Buyer." Section 2-103.

"Good faith." Section 1-201.

"Goods." Section 2-105.

"Lot." Section 2-105.

"Notice." Section 1-201.

"Sale." Section 2-106.

"Seller." Section 2-103.

§ 28-2-329. Voluntary and unsolicited sending of goods. — No person, firm, partnership, association or corporation, or agent or employee thereof, shall, in any manner, or by any means, offer for sale goods, wares, or merchandise, where the offer includes the voluntary and unsolicited sending of goods, wares, or merchandise not actually ordered or requested by the recipient, either orally or in writing. The receipt of any such unsolicited goods, wares, or merchandise shall for all purposes be deemed an unconditional gift to the recipient who may use or dispose of the same in any manner he sees fit without any obligation on his part to the sender.

History.

1969, ch. 46, § 1, p. 124.

STATUTORY NOTES

Compiler's Notes.

This section is not a part of the Uniform Commercial Code.

Part 4
Title, Creditors and Good Faith Purchasers

Idaho Code § 28-2-401

§ 28-2-401. Passing of title — Reservation for security — Limited application of this section. — Each provision of this chapter with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title. Insofar as situations are not covered by the other provisions of this chapter and matters concerning title become material the following rules apply:

(1) Title to goods cannot pass under a contract for sale prior to their identification to the contract (section 28-2-501[, Idaho Code]), and unless otherwise explicitly agreed the buyer acquires by their identification a special property as limited by this act. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the chapter on secured transactions (chapter 9[, title 28, Idaho Code]), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest and even though a document of title is to be delivered at a different time or place; and in particular and despite any reservation of a security interest by the bill of lading (a) if the contract requires or authorizes the seller to send the goods to the buyer but does not require him to deliver them at destination, title passes to the buyer at the time and place of shipment; but (b) if the contract requires delivery at destination, title passes on tender there.

(3) Unless otherwise explicitly agreed where delivery is to be made without moving the goods, (a) if the seller is to deliver a tangible document of title, title passes at the time when and the place where he delivers such

documents and if the seller is to deliver an electronic document of title, title passes when the seller delivers the document; or (b) if the goods are at the time of contracting already identified and no documents of title are to be delivered, title passes at the time and place of contracting.

(4) A rejection or other refusal by the buyer to receive or retain the goods, whether or not justified, or a justified revocation of acceptance revests title to the goods in the seller. Such revesting occurs by operation of law and is not a "sale."

History.

1967, ch. 161, § 2-401, p. 351; am. 2004, ch. 42, § 8, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in two places in subsection (1) were added by the compiler to conform to the statutory citation style.

The term "this act" at the end of the first sentence in subsection (1) refers to S.L. 1967, ch. 161, which is compiled generally in chapters 1 to 10, title 28, Idaho Code. The reference probably should be to the entire Uniform Commercial Code.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Application.

The official comment to paragraph (2)(a) of this section makes it clear that the Uniform Commercial Code's determination of the situs of sale, or transfer of title, is not controlling in determining whether a public regulation applies to a given transaction. State v. Maybee, 148 Idaho 520, 224 P.3d 1109, cert. denied, 562 U.S. 835, 131 S. Ct. 150, 178 L. Ed. 2d 37 (2010).

Because the unambiguous terms of a contract made clear that a debtor purchased a vehicle from creditor, obligated debtor to pay creditor the amount financed, and granted creditor a security interest in the vehicle, creditor's interest in the vehicle was limited to a security interest under the Idaho UCC. Hillen v. Dennis Dillon Auto Park & Truck Center, Inc. (In re Byrd), 546 B.R. 434 (Bankr. D. Idaho 2016).

Limitation on Role of Title.

The UCC has firmly rejected the concept of title as the dispositive factor in determining the rights and obligations of parties to personal property. State v. Burris, 101 Idaho 683, 619 P.2d 1136 (1980).

Ownership.

If an individual takes merchandise without any intent to pay for it, he or she has unlawfully obtained the merchandise and has no lawful ownership interest in it. State v. Dix, — Idaho —, — P.3d —, 2019 Ida. App. LEXIS 7 (Ct. App. Feb. 27, 2019).

Perfection of Security Interest.

Where debtor's sight draft was dishonored three days after debtor took possession of automobile and seller made demand for return within ten days after transfer of possession and dishonor, seller was entitled to return of automobile since seller's security interest under this section was perfected. Swayne v. Idaho Auto Auction (In re Shoemaker), 4 Bankr. 505 (Bankr. D. Idaho 1980).

Time of Transfer of Title.

Since there was no evidence of any agreement between multiple listing service and real estate broker regarding transfer of title, title to the multiple listing booklets was transferred to the real estate broker upon delivery. The transfer was "for a consideration"; thus, there was a sale of the multiple

listing booklets by the multiple listing service to the real estate broker. This sale was a "sale at retail" since real estate broker had no intention of reselling those books and, in fact, was prohibited from doing so by the bylaws of the multiple listing service. Old W. Realty, Inc. v. Idaho State Tax Comm'n, 110 Idaho 546, 716 P.2d 1318 (1986).

Paragraph (2)(a) states when title to sold goods passes for shipment contracts and paragraph (2)(b) states when title passes under destination contracts. Under a shipment contract, a seller delivers the goods to a third party to transport the goods to the place required under the contract, and title passes when the goods are delivered to the person who will transport them. The effect of the Uniform Commercial Code is that, in a "shipment" contract, the most commonly used method, delivery to the carrier is delivery to the buyer. A delivery by direction of the buyer to a third person as an intermediary to ship the goods is a good delivery to the buyer. Deiter v. Coons, 162 Idaho 44, 394 P.3d 87 (2017).

If parties to a contract for the sale of goods intend that delivery be made to a carrier, a request in the buyer's letter to the seller that the goods be shipped to the buyer's residence is a mere shipping instruction that does not convert the contract to a destination contract, and the risk of loss passes to the buyer at the time the goods are delivered to a carrier, such as the postal service. Thus, a "ship to" term has no significance in determining whether a contract is a shipment or destination contract for risk of loss purposes. Deiter v. Coons, 162 Idaho 44, 394 P.3d 87 (2017).

Title of Commodity.

The sale of a commodity to a warehouse involves a passage of title to the commodity. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Cited State v. Jesser, 95 Idaho 43, 501 P.2d 727 (1972); Whitworth v. Krueger, 98 Idaho 65, 558 P.2d 1026 (1976); Seitz v. Stecklein, 111 Idaho 364, 723 P.2d 908 (Ct. App. 1986); State v. Bennett, 150 Idaho 278, 246 P.3d 387 (2010).

Decisions Under Prior Law

Ascertainment of goods.

Delivery of bill of sale.

Ascertainment of Goods.

Plaintiff did not have such title or right to immediate possession of a quantity of a specified grade of potatoes as would support an action for conversion against a third party who obtained potatoes from seller who was under contract to sell to plaintiff as the contract of sale was not for specific goods and things remained to be done, such as inspecting the potatoes to obtain from the general mass potatoes of the quality and size specified, segregating them, and appropriating to the contract; therefore, the contract was executory and the right to immediate possession was vested in the buyer at the time of the alleged conversion. National Produce Distrib., Inc. v. Miles & Myers, Inc., 75 Idaho 460, 274 P.2d 831 (1954).

Delivery of Bill of Sale.

Property in goods sold passed to buyer when bill of sale was made regardless of fact that time of delivery of property was postponed. Walker v. Lightfoot, 124 F.2d 3 (9th Cir. 1941).

In order to transfer title to a chattel, it was not necessary that actual possession also be transferred, where the rights of no creditor, subsequent purchaser or incumbrancer are involved; therefore, the delivery of the bill of sale to plaintiff was a constructive delivery of the chattels covered thereby, sufficient as against defendant. Molloy v. Beard, 42 Idaho 115, 243 P. 823 (1926).

Evidence Supporting Allegation of Fixed Price.

In an action on contract for the contract price, it was usually immaterial what the reasonable value of the subject of the sale may have been, but in support of the claim that a fixed price was agreed upon, it was often permissible to support such allegation by proof that the price claimed to have been agreed upon was a reasonable price, and especially was such testimony permissible where it was claimed that the price charged was excessive and not agreed upon. McMaster v. Dunn, 49 Idaho 241, 287 P. 201 (1930). See also Lewis, Cooper & Hancock v. Utah Constr. Co., 10 Idaho 214, 77 P. 336 (1904).

Intention.

Intention of parties determines passing of title. Shipman v. Kloppenburg, 72 Idaho 321, 240 P.2d 1151 (1952).

Passing of Property.

The property in goods sold passed to the buyer when a bill of sale was made, regardless of the fact that the time of the delivery was postponed. Walker v. Lightfoot, 124 F.2d 3 (9th Cir. 1941).

Unless a different intention appears, if a seller was bound to do something to put goods into a deliverable shape, the property did not pass until such thing was done, or, if the contract required the seller to deliver goods to the buyer, it did not pass until the goods had been delivered. Bowman v. Adams, 45 Idaho 217, 261 P. 679 (1927).

Question of Sale for Jury.

Where it was claimed that cattle were bought by the purchaser without inspecting them and that he accepted them upon delivery and appropriated and used them, all of which was denied by the purchaser, the question as to whether there had been a sale was for the jury. McMaster v. Dunn, 49 Idaho 241, 287 P. 201 (1930).

Sale with Agreement to Repurchase.

Under contract for sale and repurchase of sheep to be fattened, it being provided that buyers were to make delivery on resale, title did not pass back to seller when seller refused to accept sheep back from buyers on inspection before delivery. Bowman v. Adams, 45 Idaho 217, 261 P. 679 (1927).

Under contract whereby sheep were sold to be fattened and only fat sheep repurchased by seller, vendee obtains complete title unburdened of trust in vendor's favor. In such case mortgage of property, even with knowledge of contractual rights, was valid. Bowman v. Adams, 45 Idaho 217, 261 P. 679 (1927).

Verbal Arrangement for Reduction to Writing.

Whether sale was complete or contract merely executory, under evidence, was matter for jury. Such question was usually one of intent of parties as gathered from their contract and circumstances surrounding sale. Elliott v. Pope, 42 Idaho 505, 247 P. 796 (1926).

Whether verbal arrangement, with agreement to reduce contract to writing, creates binding contract until completed by written terms was question for jury. Elliott v. Pope, 42 Idaho 505, 247 P. 796 (1926).

What Constitutes Acceptance.

Where acts and conduct of buyer after delivery of goods were inconsistent with idea of ownership in seller, there was acceptance within meaning of statute. Gross Mfg. Co. v. Redfield, 48 Idaho 399, 282 P. 487 (1929); Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

Where buyer sold part of goods delivered in usual course of his business, there was acceptance of entire consignment, notwithstanding attempted return of balance. Gross Mfg. Co. v. Redfield, 48 Idaho 399, 282 P. 487 (1929); Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

Where Goods Deliverable.

Where purchaser contracted for "strictly number one merchantable hay," it could not be compelled to take delivery of hay other than that grade, and until hay of that grade was segregated, it was not in a deliverable state. Idaho Prods. Co. v. Bales, 36 Idaho 800, 214 P. 206 (1923).

OPINIONS OF ATTORNEY GENERAL

Situs of Sale.

When delivery of building materials occurs in the City of Sun Valley, and there is no specific provision in the sales contract to the contrary, title passes at the time of delivery, which is the time of sale. If the seller is a retailer required to have a city sales tax permit, the city may require the seller to collect city sales tax on the sale and remit the tax to the city. OAG 91-6.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 360 et seq 68A Am. Jur. 2d, Secured Transactions, § 204 et seq.

C.J.S. — 77A C.J.S., Sales, § 239 et seq.

Official Comment

Prior Uniform Statutory Provision: See generally, Sections 17, 18, 19 and 20, Uniform Sales Act.

Purposes: To make it clear that:

1. This Article [Chapter] deals with the issues between seller and buyer in terms of step by step performance or nonperformance under the contract for sale and not in terms of whether or not "title" to the goods has passed. That the rules of this section in no way alter the rights of either the buyer, seller or third parties declared elsewhere in the Article [Chapter] is made clear by the preamble of this section. This section, however, in no way intends to indicate which line of interpretation should be followed in cases where the applicability of "public" regulation depends upon a "sale" or upon location of "title" without further definition. The basic policy of this Article [Chapter] that known purpose and reason should govern interpretation cannot extend beyond the scope of its own provisions. It is therefore necessary to state what a "sale" is and when title passes under this Article [Chapter] in case the courts deem any public regulation to incorporate the defined term of the "private" law.

2. "Future" goods cannot be the subject of a present sale. Before title can pass the goods must be identified in the manner set forth in Section 2-501. The parties, however, have full liberty to arrange by specific terms for the passing of title to goods which are existing.

3. The "special property" of the buyer in goods identified to the contract is excluded from the definition of "security interest"; its incidents are defined in provisions of this Article [Chapter] such as those on the rights of the seller's creditors, on good faith purchase, on the buyer's right to goods on the seller's insolvency, and on the buyer's right to specific performance or replevin.

4. The factual situations in subsections (2) and (3) upon which passage of title turn actually base the test upon the time when the seller has finally committed himself in regard to specific goods. Thus in a "shipment" contract he commits himself by the act of making the shipment. If shipment is not contemplated subsection (3) turns on the seller's final commitment, *i.e.* the delivery of documents or the making of the contract. As to delivery of an electronic document of title, see definition of delivery in Article 1, Section 1-201. This Article does not state a rule as to the place of title passage as to goods covered by an electronic document of title.

Cross References: Point 2: Sections 2-102, 2-501 and 2-502.

Point 3: Sections 1-201, 2-402, 2-403, 2-502 and 2-716.

Definitional Cross References: "Agreement." Section 1-201.

"Bill of lading." Section 1-201.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Delivery." Section 1-201.

"Document of title." Section 1-201.

"Good faith." Section 2-103.

"Goods." Section 2-105.

"Party." Section 1-201.

"Purchaser." Section 1-201.

"Receipt" of goods. Section 2-103.

"Remedy." Section 1-201.

"Rights." Section 1-201.

"Sale." Section 2-106.

"Security interest." Section 1-201.

"Seller." Section 2-103.

"Send." Section 1-201.

§ 28-2-402. Rights of seller's creditors against sold goods. — (1) Except as provided in subsections (2) and (3), rights of unsecured creditors of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this chapter (sections 28-2-502 and 28-2-716[, Idaho Code]).

(2) A creditor of the seller may treat a sale or an identification of goods to a contract for sale as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent.

(3) Nothing in this chapter shall be deemed to impair the rights of creditors of the seller (a) under the provisions of the chapter on Secured Transactions (chapter 9[, title 28, Idaho Code]); or (b) where identification to the contract or delivery is made not in current course of trade but in satisfaction of or as security for a pre-existing claim for money, security or the like and is made under circumstances which under any rule of law of the state where the goods are situated would apart from this chapter constitute the transaction a fraudulent transfer or voidable preference.

History.

1967, ch. 161, § 2-402, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (1) and paragraph (3)(a) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Good Faith Purchaser for Value.

Although a seller of goods may have certain rights to recover goods from an insolvent buyer and may treat a sale as void if retention of the goods is fraudulent, nevertheless those rights are altered when the goods enter the hands of a good faith purchaser for value. Western Idaho Prod. Credit Ass'n v. Simplot Feed Lots, Inc., 106 Idaho 260, 678 P.2d 52 (1984).

Decisions Under Prior Law Time Title Passes.

The property in goods passed to the buyer when a bill of sale was made, regardless of the fact that the time of delivery was postponed. Walker v. Lightfoot, 124 F.2d 3 (9th Cir. 1941).

RESEARCH REFERENCES

Idaho Law Review. — Choice of Law in Idaho: A Survey and Critique of Idaho Cases, Andrew S. Jorgensen. 49 Idaho L. Rev. 547 (2013).

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, §§ 63, 64.

67A Am. Jur. 2d, Sales, § 795 et seq.

Official Comment

Prior Uniform Statutory Provision: Subsection (2) — Section 26, Uniform Sales Act; Subsections (1) and (3) — none.

Changes: Rephrased.

Purposes of Changes and New Matter: To avoid confusion on ordinary issues between current sellers and buyers and issues in the field of preference and hindrance by making it clear that: 1. Local law on questions of hindrance of creditors by the seller's retention of possession of the goods are outside the scope of this Article [Chapter], but retention of possession in the current course of trade is legitimate. Transactions which fall within the law's policy against improper preferences are reserved from the protection of this Article [Chapter].

2. The retention of possession of the goods by a merchant seller for a commercially reasonable time after a sale or identification in current course is exempted from attack as fraudulent. Similarly, the provisions of subsection (3) have no application to identification or delivery made in the

current course of trade, as measured against general commercial understanding of what a "current" transaction is.

Definitional Cross References: "Contract for sale." Section 2-106.

"Creditor." Section 1-201.

"Good faith." Section 2-103.

"Goods." Section 2-105.

"Merchant." Section 2-104.

"Money." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Rights." Section 1-201.

"Sale." Section 2-106.

"Seller." Section 2-103.

§ 28-2-403. Power to transfer — Good faith purchase of goods — “Entrusting.” — (1) A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value. When goods have been delivered under a transaction of purchase, the purchaser has such power even though:

(a) The transferor was deceived as to the identity of the purchaser; or (b) The delivery was in exchange for a check which is later dishonored; or (c) It was agreed that the transaction was to be a “cash sale”; or (d) The delivery was procured through fraud punishable as larcenous under the criminal law.

(2) Any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business.

(3) “Entrusting” includes any delivery and any acquiescence in retention of possession regardless of any condition expressed between the parties to the delivery or acquiescence and regardless of whether the procurement of the entrusting or the possessor’s disposition of the goods has been such as to be larcenous under the criminal law.

(4) The rights of other purchasers of goods and of lien creditors are governed by the chapters on secured transactions (chapter 9[, title 28 Idaho Code]) and documents of title (chapter 7[, title 28, Idaho Code]).

History.

1967, ch. 161, § 2-403, p. 351; am. 1993, ch. 288, § 50, p. 1019; am. 2001, ch. 21, § 1, p. 27.

STATUTORY NOTES

Compiler’s Notes.

The bracketed insertions in subsection (4) were added by the compiler to conform to the statutory citation style.

Section 54 of S.L. 1993, ch. 288 read: "Rights and obligations that arose under Chapter 6, Title 28, Idaho Code, and Section 28-9-111, Idaho Code, before their repeal remain valid and may be enforced as though those statutes had not been repealed."

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Cancellation of Preexisting Debt.

Where the consideration given by the buyer of a farm disc from a consignment exchange was cancellation of a preexisting debt owed to him by the exchange, the buyer was not a "buyer in ordinary course of business." Seitz v. Stecklein, 111 Idaho 364, 723 P.2d 908 (Ct. App. 1986).

Delivery.

Delivery can, in some circumstances, be effectuated without a change of possession, but actual delivery must be required where fungible goods are left in the possession of a warehouseman by the purchaser in order for the entrustment provisions to be effective. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Entrustment Provisions.

To require delivery to the purchaser of the goods under the entrustment provisions, particularly in the instance of fungible goods in warehouses,

illustrates the basic purpose of the entrustment theory, which is to afford protection to a bona fide purchaser in the ordinary course of business. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Good Faith Purchaser for Value.

Although a seller of goods may have certain rights to recover goods from an insolvent buyer and may treat a sale as void if retention of the goods is fraudulent, nevertheless those rights are altered when the goods enter the hands of a good faith purchaser for value. Western Idaho Prod. Credit Ass'n v. Simplot Feed Lots, Inc., 106 Idaho 260, 678 P.2d 52 (1984).

Possession by Warehouse.

Subsections (2) and (3) of this section were not applicable to warehouse deposits of beans since the purchasers of these beans did not take possession of them, but, instead, left them in the custody and possession of the warehouse. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Purchase from Warehouse.

Delivery to the purchaser is required by § 28-7-205 before a purchaser takes free of any claim under a warehouse receipt. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Purpose.

The purpose and intent of sections (2) and (3) of this section is to afford title protection to a commodity purchaser as against the unpaid depositor of the commodity in situations other than a warehouse in a shortage position. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Decisions Under Prior Law

Good faith and value.

Innocent third party.

Property in possession of third person.

Remedies.

Good Faith and Value.

Mortgagee of personal property under mortgage securing antecedent debt was held an encumbrancer both in good faith and for value holding a lien

superior to claim of purchaser of such property who had not removed it from seller's premises. Millick v. Stevens, 44 Idaho 347, 257 P. 30 (1927).

Innocent Third Party.

The principal is well settled that a seller of personal property can convey no greater title than he had, it makes no difference that the purchaser had no notice and was ignorant of other parties in interest. Federal Land Bank v. McCloud, 52 Idaho 694, 20 P.2d 201 (1933).

Property in Possession of Third Person.

The owner of personal property, placing an agent or employee in possession and control thereof, did not thereby clothe such agent or employee with authority to sell such property, nor was possession alone sufficient to estop the owner from asserting his title against one who purchased from such agent or employee in reliance upon the latter's apparent authority to sell. Brunette v. Idaho Veneer Co., 86 Idaho 193, 384 P.2d 233 (1963).

Where defendant did not rely upon acts and representations of the owner but instead relied upon the fact that an agent had possession of the logs and defendant was satisfied with agent's statements as to his authority, since the court held that agent advised the defendant that plaintiff had an interest in the logs, it became the duty of the defendant to make inquiry as to what interest plaintiff had, and he was bound to know the facts that inquiry would have disclosed. Brunette v. Idaho Veneer Co., 86 Idaho 193, 384 P.2d 233 (1963).

Remedies.

Holder of a trust receipt on car sold by trustee to another dealer was entitled to recognize the sale and pursue its remedy against proceeds of sale deposited in the trustee's bank. Commercial Credit Corp. v. Bosse, 76 Idaho 409, 283 P.2d 937 (1955).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 52 et seq.

67 Am. Jur. 2d, Sales, § 434 et seq.

Official Comment

Prior Uniform Statutory Provision: Sections 20(4), 23, 24, 25, Uniform Sales Act; Section 9, especially 9(2), Uniform Trust Receipts Act; Section 9, Uniform Conditional Sales Act.

Changes: Consolidated and rewritten.

Purposes of Changes: To gather together a series of prior uniform statutory provisions and the case-law thereunder and to state a unified and simplified policy on good faith purchase of goods.

1. The basic policy of our law allowing transfer of such title as the transferor has is generally continued and expanded under subsection (1). In this respect the provisions of the section are applicable to a person taking by any form of "purchase" as defined by this Act. Moreover the policy of this Act expressly providing for the application of supplementary general principles of law to sales transactions wherever appropriate joins with the present section to continue unimpaired all rights acquired under the law of agency or of apparent agency or ownership or other estoppel, whether based on statutory provisions or on case law principles. The section also leaves unimpaired the powers given to selling factors under the earlier Factors Acts. In addition subsection (1) provides specifically for the protection of the good faith purchaser for value in a number of specific situations which have been troublesome under prior law.

On the other hand, the contract of purchase is of course limited by its own terms as in a case of pledge for a limited amount or of sale of a fractional interest in goods.

2. The many particular situations in which a buyer in ordinary course of business from a dealer has been protected against reservation of property or other hidden interest are gathered by subsections (2)-(4) into a single principle protecting persons who buy in ordinary course out of inventory. Consignors have no reason to complain, nor have lenders who hold a security interest in the inventory, since the very purpose of goods in inventory is to be turned into cash by sale.

The principle is extended in subsection (3) to fit with the abolition of the old law of "cash sale" by subsection (1) (c). It is also freed from any technicalities depending on the extended law of larceny; such extension of

the concept of theft to include trick, particular types of fraud, and the like is for the purpose of helping conviction of the offender; it has no proper application to the long-standing policy of civil protection of buyers from persons guilty of such trick or fraud. Finally, the policy is extended, in the interest of simplicity and sense, to any entrusting by a bailor; this is in consonance with the explicit provisions of Section 7-205 on the powers of a warehouseman who is also in the business of buying and selling fungible goods of the kind he warehouses. As to entrusting by a secured party, subsection (2) is limited by the more specific provisions of Section 9-307 (1), which deny protection to a person buying farm products from a person engaged in farming operations.

3. The definition of "buyer in ordinary course of business" (Section 1-201) is effective here and preserves the essence of the healthy limitations engrafted by the case-law on the older statutes. The older loose concept of good faith and wide definition of value combined to create apparent good faith purchasers in many situations in which the result outraged common sense; the court's solution was to protect the original title especially by use of "cash sale" or of over-technical construction of the enabling clauses of the statutes. But such rulings then turned into limitations on the proper protection of buyers in the ordinary market. Section 1-201 (9) cuts down the category of buyer in ordinary course in such fashion as to take care of the results of the cases, but with no price either in confusion or in injustice to proper dealings in the normal market.

4. Except as provided in subsection (1), the rights of purchasers other than buyers in ordinary course are left to the Articles [Chapters] on Secured Transactions, Documents of Title, and Bulk Sales.

Cross References: Point 1: Sections 1-103 and 1-201.

Point 2: Sections 1-201, 2-402, 7-205 and 9-307 (1).

Points 3 and 4: Sections 1-102, 1-201, 2-104, 2-707 and Articles [Chapters] 6, 7 and 9.

Definitional Cross References: "Buyer in ordinary course of business." Section 1-201.

"Good faith." Sections 1-201 and 2-103.

"Goods." Section 2-105.

"Person." Section 1-201.

"Purchaser." Section 1-201.

"Signed." Section 1-201.

"Term." Section 1-201.

"Value." Section 1-201 [now 1-204].

Part 5
Performance

Idaho Code § 28-2-501

§ 28-2-501. Insurable interest in goods — Manner of identification of goods. — (1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are nonconforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs

(a) when the contract is made if it is for the sale of goods already existing and identified; (b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers; (c) when the crops are planted or otherwise become growing crops or the young are conceived if the contract is for the sale of unborn young to be born within twelve (12) months after contracting or for the sale of crops to be harvested within twelve (12) months or the next normal harvest season after contracting whichever is longer.

(2) The seller retains an insurable interest in goods so long as title to or any security interest in the goods remains in him and where the identification is by the seller alone he may until default or insolvency or notification to the buyer that the identification is final substitute other goods for those identified.

(3) Nothing in this section impairs any insurable interest recognized under any other statute or rule of law.

History.

1967, ch. 161, § 2-501, p. 351.

CASE NOTES

Cited In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

Decisions Under Prior Law

Party Liable for Damage.

Where one sold potatoes stored in the cellar of a third person and agreed to run the potatoes over an eliminator, haul the commercial potatoes to the purchaser's warehouse, and buy back the seed potatoes in the cellar, whereupon the purchaser notified the third party that it was now the owner of the potatoes, and, in loading potatoes on trucks several months later, they were discovered to have been damaged in the meanwhile by frost, the frost damage fell upon the purchaser. Martin v. Whiteley, 89 Idaho 429, 405 P.2d 963 (1965).

Passing of Property.

Unless a different intention appears, if a seller was bound to do something to put goods into a deliverable shape, the property did not pass until such thing was done, or, if the contract requires the seller to deliver goods to the buyer, it did not pass until the goods had been delivered. Bowman v. Adams, 45 Idaho 217, 261 P. 679 (1927).

Question of Sale for Jury.

Where it was claimed that cattle were bought by the purchaser without inspecting them and that he accepted them upon delivery and appropriated and used them, all of which was denied by purchaser, the question of whether there had been a sale was for the jury. McMaster v. Dunn, 49 Idaho 241, 287 P. 201 (1930).

When Goods Deliverable.

Where purchaser contracted for strictly "number one merchantable hay," it could not be compelled to take delivery of hay other than that grade, and

until hay of that grade was segregated, it was not in a deliverable state. Idaho Prods. Co. v. Bales, 36 Idaho 800, 214 P. 206 (1923).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 368 et seq.

C.J.S. — 77A C.J.S., Sales, § 239 et seq.

Official Comment

Prior Uniform Statutory Provision: See Sections 17 and 19, Uniform Sales Act.

Purposes: 1. The present section deals with the manner of identifying goods to the contract so that an insurable interest in the buyer and the rights set forth in the next section will accrue. Generally speaking, identification may be made in any manner "explicitly agreed to" by the parties. The rules of paragraphs (a), (b) and (c) apply only in the absence of such "explicit agreement."

2. In the ordinary case identification of particular existing goods as goods to which the contract refers is unambiguous and may occur in one of many ways. It is possible, however, for the identification to be tentative or contingent. In view of the limited effect given to identification by this Article [Chapter], the general policy is to resolve all doubts in favor of identification.

3. The provision of this section as to "explicit agreement" clarifies the present confusion in the law of sales which has arisen from the fact that under prior uniform legislation all rules of presumption with reference to the passing of title or to appropriation (which in turn depended upon identification) were regarded as subject to the contrary intention of the parties or of the party appropriating. Such uncertainty is reduced to a minimum under this section by requiring "explicit agreement" of the parties before the rules of paragraphs (a), (b) and (c) are displaced — as they would be by a term giving the buyer power to select the goods. An "explicit" agreement, however, need not necessarily be found in the terms used in the particular transaction. Thus, where a usage of the trade has previously been made explicit by reduction to a standard set of "rules and

regulations" currently incorporated by reference into the contracts of the parties, a relevant provision of those "rules and regulations" is "explicit" within the meaning of this section.

4. In view of the limited function of identification there is no requirement in this section that the goods be in deliverable state or that all of the seller's duties with respect to the processing of the goods be completed in order that identification occur. For example, despite identification the risk of loss remains on the seller under the risk of loss provisions until completion of his duties as to the goods and all of his remedies remain dependent upon his not defaulting under the contract.

5. Undivided shares in an identified fungible bulk, such as grain in an elevator or oil in a storage tank, can be sold. The mere making of the contract with reference to an undivided share in an identified fungible bulk is enough under subsection (a) to effect an identification if there is no explicit agreement otherwise. The seller's duty, however, to segregate and deliver according to the contract is not affected by such an identification but is controlled by other provisions of this Article [Chapter].

6. Identification of crops under paragraph (c) is made upon planting only if they are to be harvested within the year or within the next normal harvest season. The phrase "next normal harvest season" fairly includes nursery stock raised for normally quick "harvest," but plainly excludes a "timber" crop to which the concept of a harvest "season" is inapplicable.

Paragraph (c) is also applicable to a crop of wool or the young of animals to be born within twelve months after contracting. The product of a lumbering, mining or fishing operation, though seasonal, is not within the concept of "growing." Identification under a contract for all or part of the output of such an operation can be effected early in the operation.

Cross References: Point 1: Section 2-502.

Point 4: Sections 2-509, 2-510 and 2-703.

Point 5: Sections 2-105, 2-308, 2-503 and 2-509.

Point 6: Sections 2-105 (1), 2-107 (1) and 2-402.

Definitional Cross References: "Agreement." Section 1-201.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Future goods." Section 2-105.

"Goods." Section 2-105.

"Notification." Section 1-201.

"Party." Section 1-201.

"Sale." Section 2-106.

"Security interest." Section 1-201.

"Seller." Section 2-103.

§ 28-2-502. Buyer's right to goods on seller's repudiation, failure to deliver, or insolvency. — (1) Subject to subsections (2) and (3) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of section 28-2-501[, Idaho Code], may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if:

(a) In the case of goods bought for personal, family or household purposes, the seller repudiates or fails to deliver as required by the contract; or (b) In all cases, the seller becomes insolvent within ten (10) days after receipt of the first installment on their price.

(2) The buyer's right to recover the goods under subsection (1)(a) vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

(3) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

History.

1967, ch. 161, § 2-502, p. 351; am. 2001, ch. 208, § 8, p. 704.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in the introductory paragraph in subsection (1) was added by the compiler to conform to the statutory citation style.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 368 et seq.

Official Comment

Prior Uniform Statutory Provision: Compare Sections 17, 18 and 19, Uniform Sales Act.

Purposes: 1. This section gives an additional right to the buyer as a result of identification of the goods to the contract in the manner provided in Section 2-501. The buyer is given a right to the goods on the seller's insolvency occurring within 10 days after he receives the first installment on their price.

2. The question of whether the buyer also acquires a security interest in identified goods and has rights to the goods when insolvency takes place after the ten-day period provided in this section depends upon compliance with the provisions of the Article [Chapter] on Secured Transactions (Article [Chapter] 9).

3. Subsection (2) is included to preclude the possibility of unjust enrichment which exists if the buyer were permitted to recover goods even though they were greatly superior in quality or quantity to that called for by the contract for sale.

Cross References: Point 1: Sections 1-201 and 2-702.

Point 2: Article [Chapter] 9.

Definitional Cross References: "Buyer." Section 2-103.

"Conform." Section 2-106.

"Contract for sale." Section 2-106.

"Goods." Section 2-105.

"Insolvent." Section 1-201.

"Rights." Section 1-201.

"Seller." Section 2-103.

§ 28-2-503. Manner of seller's tender of delivery. — (1) Tender of delivery requires that the seller put and hold conforming goods at the buyer's disposition and give the buyer any notification reasonably necessary to enable him to take delivery. The manner, time and place for tender are determined by the agreement and this chapter, and in particular

(a) tender must be at a reasonable hour, and if it is of goods they must be kept available for the period reasonably necessary to enable the buyer to take possession; but (b) unless otherwise agreed the buyer must furnish facilities reasonably suited to the receipt of the goods.

(2) Where the case is within the next section respecting shipment tender requires that the seller comply with its provisions.

(3) Where the seller is required to deliver at a particular destination tender requires that he comply with subsection (1) and also in any appropriate case tender documents as described in subsections (4) and (5) of this section.

(4) Where goods are in the possession of a bailee and are to be delivered without being moved (a) tender requires that the seller either tender a negotiable document of title covering such goods or procure acknowledgment by the bailee of the buyer's right to possession of the goods; but (b) tender to the buyer of a nonnegotiable document of title or of a record directing to the bailee to deliver is sufficient tender unless the buyer seasonably objects, and except as otherwise provided in chapter 9, title 28, Idaho Code, receipt by the bailee of notification of the buyer's rights fixes those rights as against the bailee and all third persons; but risk of loss of the goods and of any failure by the bailee to honor the nonnegotiable document of title or to obey the direction remains on the seller until the buyer has had a reasonable time to present the document or direction, and a refusal by the bailee to honor the document or to obey the direction defeats the tender.

(5) Where the contract requires the seller to deliver documents (a) he must tender all such documents in correct form, except as provided in this

chapter with respect to bills of lading in a set (subsection (2) of section 28-2-323[, Idaho Code]); and (b) tender through customary banking channels is sufficient and dishonor of a draft accompanying or associated with the documents constitutes nonacceptance or rejection.

History.

1967, ch. 161, § 2-503, p. 351; am. 2004, ch. 42, § 9, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion at the end of paragraph (5)(a) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Delivery.

This section deals with the manner of the seller's tender of delivery. Subsection (2) refers to delivery under a shipment contract, while subsection (3) deals with delivery under a destination contract. Deiter v. Coons, 162 Idaho 44, 394 P.3d 87 (2017).

If parties to a contract for the sale of goods intend that delivery be made to a carrier, a request in the buyer's letter to the seller that the goods be shipped to the buyer's residence is a mere shipping instruction that does not convert the contract to a destination contract, and the risk of loss passes to the buyer at the time the goods are delivered to a carrier, such as the postal service. Thus, a "ship to" term has no significance in determining whether a contract is a shipment or destination contract for risk of loss purposes. Deiter v. Coons, 162 Idaho 44, 394 P.3d 87 (2017).

Tender of Specified Documents.

The fact that a transaction was simple, or that the dispute concerned the failure to tender specified documents rather than a failure to deliver conforming goods, does not exempt a case from the UCC's provisions; rather, the code specifically provides that where parties agree that tender requires the seller to deliver documents, the seller must tender all such documents in correct form and, further, tender of delivery is a condition to the buyer's duty to accept goods and to his duty to pay for them. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Cited In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 489 et seq.

ALR. — Applicability of UCC Article 2 to Mixed Contracts for Sale of Goods and Services: Distributorship, Franchise, and Similar Business Contracts. 8 A.L.R.7th 4.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Business Goods and Services: Manufacturing, Construction, and Similar Contracts. 15 A.L.R.7th 7.

Official Comment

Prior Uniform Statutory Provision: See Sections 11, 19, 20, 43 (3) and (4), 46 and 51, Uniform Sales Act.

Changes: The general policy of the above sections is continued and supplemented but subsection (3) changes the rule of prior section 19 (5) as to what constitutes a "destination" contract and subsection (4) incorporates a minor correction as to tender of delivery of goods in the possession of a bailee.

Purposes of Changes: 1. The major general rules governing the manner of proper or due tender of delivery are gathered in this section. The term "tender" is used in this Article [Chapter] in two different senses. In one sense it refers to "due tender" which contemplates an offer coupled with a present ability to fulfill all the conditions resting on the tendering party and

must be followed by actual performance if the other party shows himself ready to proceed. Unless the context unmistakably indicates otherwise this is the meaning of "tender" in this Article [Chapter] and the occasional addition of the word "due" is only for clarity and emphasis. At other times it is used to refer to an offer of goods or documents under a contract as if in fulfillment of its conditions even though there is a defect when measured against the contract obligation. Used in either sense, however, "tender" connotes such performance by the tendering party as puts the other party in default if he fails to proceed in some manner. These concepts of tender would apply to tender of either tangible or electronic documents of title.

2. The seller's general duty to tender and deliver is laid down in Section 2-301 and more particularly in Section 2-507. The seller's right to a receipt if he demands one and receipts are customary is governed by Section 1-205 [1-303]. Subsection (1) of the present section proceeds to set forth two primary requirements of tender: first, that the seller "put and hold conforming goods at the buyer's disposition" and, second, that he "give the buyer any notice reasonably necessary to enable him to take delivery."

In cases in which payment is due and demanded upon delivery the "buyer's disposition" is qualified by the seller's right to retain control of the goods until payment by the provision of this Article [Chapter] on delivery on condition. However, where the seller is demanding payment on delivery he must first allow the buyer to inspect the goods in order to avoid impairing his tender unless the contract for sale is on C.I.F., C.O.D., cash against documents or similar terms negating the privilege of inspection before payment.

In the case of contracts involving documents the seller can "put and hold conforming goods at the buyer's disposition" under subsection (1) by tendering documents which give the buyer complete control of the goods under the provisions of Article [Chapter] 7 on due negotiation.

3. Under paragraph (a) of subsection (1) usage of the trade and the circumstances of the particular case determine what is a reasonable hour for tender and what constitutes a reasonable period of holding the goods available.

4. The buyer must furnish reasonable facilities for the receipt of the goods tendered by the seller under subsection (1), paragraph (b). This

obligation of the buyer is no part of the seller's tender.

5. For the purposes of subsections (2) and (3) there is omitted from this Article [Chapter] the rule under prior uniform legislation that a term requiring the seller to pay the freight or cost of transportation to the buyer is equivalent to an agreement by the seller to deliver to the buyer or at an agreed destination. This omission is with the specific intention of negating the rule, for under this Article [Chapter] the "shipment" contract is regarded as the normal one and the "destination" contract as the variant type. The seller is not obligated to deliver at a named destination and bear the concurrent risk of loss until arrival, unless he has specifically agreed so to deliver or the commercial understanding of the terms used by the parties contemplates such delivery.

6. Paragraph (a) of subsection (4) continues the rule of the prior uniform legislation as to acknowledgment by the bailee. Paragraph (b) of subsection (4) adopts the rule that between the buyer and the seller the risk of loss remains on the seller during a period reasonable for securing acknowledgment of the transfer from the bailee, while as against all other parties the buyer's rights are fixed as of the time the bailee receives notice of the transfer.

7. Under subsection (5) documents are never "required" except where there is an express contract term or it is plainly implicit in the peculiar circumstances of the case or in a usage of trade. Documents may, of course, be "authorized" although not required, but such cases are not within the scope of this subsection. When documents are required, there are three main requirements of this subsection: (1) "All": each required document is essential to a proper tender; (2) "Such": the documents must be the ones actually required by the contract in terms of source and substance; (3) "Correct form": all documents must be in correct form. These requirements apply to both tangible and electronic documents of title. When tender is made through customary banking channels, a draft may accompany or be associated with a document of title. The language has been broadened to allow for drafts to be associated with an electronic document of title. Compare Section 2-104(2) definition of financing agency.

When a prescribed document cannot be procured, a question of fact arises under the provision of this Article [Chapter] on substituted

performance as to whether the agreed manner of delivery is actually commercially impracticable and whether the substitute is commercially reasonable.

Cross References: Point 2: Sections 1-205 [1-303], 2-301, 2-310, 2-507 and 2-513 and Article [Chapter] 7.

Point 5: Sections 2-308, 2-310 and 2-509.

Point 7: Section 2-614(1).

Specific matters involving tender are covered in many additional sections of this Article [Chapter]. See Sections 1-205 [1-303], 2-301, 2-306 to 2-319, 2-321(3), 2-504, 2-507(2), 2-511(1), 2-513, 2-612 and 2-614.

Definitional Cross References: "Agreement." Section 1-201.

"Bill of lading." Section 1-201.

"Buyer." Section 2-103.

"Conforming." Section 2-106.

"Contract." Section 1-201.

"Delivery." Section 1-201.

"Dishonor." Section 3-508.

"Document of title." Section 1-201.

"Draft." Section 3-104.

"Goods." Section 2-105.

"Notification." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Receipt" of goods. Section 2-103.

"Rights." Section 1-201.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

"Written." Section 1-201.

§ 28-2-504. Shipment by seller. — Where the seller is required or authorized to send the goods to the buyer and the contract does not require him to deliver them at a particular destination, then unless otherwise agreed he must

(a) put the goods in the possession of such a carrier and make such a contract for their transportation as may be reasonable having regard to the nature of the goods and other circumstances of the case; and (b) obtain and promptly deliver or tender in due form any document necessary to enable the buyer to obtain possession of the goods or otherwise required by the agreement or by usage of trade; and (c) promptly notify the buyer of the shipment.

Failure to notify the buyer under paragraph (c) or to make a proper contract under paragraph (a) is a ground for rejection only if material delay or loss ensues.

History.

1967, ch. 161, § 2-504, p. 351.

CASE NOTES

Cited In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

Decisions Under Prior Law

Conditional Delivery of Contract.

Where contract was delivered conditionally, until conditions had been met buyer was under no obligation to pay nor was delivery to carrier in pursuance of the contract a completion of the contract. Continental Jewelry Co. v. Ingelstrom, 43 Idaho 337, 252 P. 186 (1926).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 507 et seq.

Official Comment

Prior Uniform Statutory Provision: Section 46, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue the general policy of the prior uniform statutory provision while incorporating certain modifications with respect to the requirement that the contract with the carrier be made expressly on behalf of the buyer and as to the necessity of giving notice of the shipment to the buyer, so that: 1. The section is limited to "shipment" contracts as contrasted with "destination" contracts or contracts for delivery at the place where the goods are located. The general principles embodied in this section cover the special cases of F.O.B. point of shipment contracts and C.I.F. and C. & F. contracts. Under the preceding section on manner of tender of delivery, due tender by the seller requires that he comply with the requirements of this section in appropriate cases.

2. The contract to be made with the carrier under paragraph (a) must conform to all express terms of the agreement, subject to any substitution necessary because of failure of agreed facilities as provided in the later provision on substituted performance. However, under the policies of this Article [Chapter] on good faith and commercial standards and on buyer's rights on improper delivery, the requirements of explicit provisions must be read in terms of their commercial and not their literal meaning. This policy is made express with respect to bills of lading in a set in the provision of this Article [Chapter] on form of bills of lading required in overseas shipment.

3. In the absence of agreement, the provision of this Article [Chapter] on options and cooperation respecting performance gives the seller the choice of any reasonable carrier, routing and other arrangements. Whether or not the shipment is at the buyer's expense the seller must see to any arrangements, reasonable in the circumstances, such as refrigeration, watering of live stock, protection against cold, the sending along of any necessary help, selection of specialized cars and the like for paragraph (a) is intended to cover all necessary arrangements whether made by contract with the carrier or otherwise. There is, however, a proper relaxation of such requirements if the buyer is himself in a position to make the appropriate

arrangements and the seller gives him reasonable notice of the need to do so. It is an improper contract under paragraph (a) for the seller to agree with the carrier to a limited valuation below the true value and thus cut off the buyer's opportunity to recover from the carrier in the event of loss, when the risk of shipment is placed on the buyer by his contract with the seller.

4. Both the language of paragraph (b) and the nature of the situation it concerns indicate that the requirement that the seller must obtain and deliver promptly to the buyer in due form any document necessary to enable him to obtain possession of the goods is intended to cumulate with the other duties of the seller such as those covered in paragraph (a).

In this connection, in the case of pool car shipments a delivery order furnished by the seller on the pool car consignee, or on the carrier for delivery out of a larger quantity, satisfies the requirements of paragraph (b) unless the contract requires some other form of document.

5. This Article [Chapter], unlike the prior uniform statutory provision, makes it the seller's duty to notify the buyer of shipment in all cases. The consequences of his failure to do so, however, are limited in that the buyer may reject on this ground only where material delay or loss ensues.

A standard and acceptable manner of notification in open credit shipments is the sending of an invoice and in the case of documentary contracts is the prompt forwarding of the documents as under paragraph (b) of this section. It is also usual to send on a straight bill of lading but this is not necessary to the required notification. However, should such a document prove necessary or convenient to the buyer, as in the case of loss and claim against the carrier, good faith would require the seller to send it on request.

Frequently the agreement expressly requires prompt notification as by wire or cable. Such a term may be of the essence and the final clause of paragraph (c) does not prevent the parties from making this a particular ground for rejection. To have this vital and irreparable effect upon the seller's duties, such a term should be part of the "dickered" terms written in any "form," or should otherwise be called seasonably and sharply to the seller's attention.

6. Generally, under the final sentence of the section, rejection by the buyer is justified only when the seller's dereliction as to any of the requirements of this section in fact is followed by material delay or damage. It rests on the seller, so far as concerns matters not within the peculiar knowledge of the buyer, to establish that his error has not been followed by events which justify rejection.

Cross References: Point 1: Sections 2-319, 2-320 and 2-503(2).

Point 2: Sections 1-203, 2-323(2), 2-601 and 2-614(1).

Point 3: Section 2-311(2).

Point 5: Section 1-203.

Definitional Cross References: "Agreement." Section 1-201.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Delivery." Section 1-201.

"Goods." Section 2-105.

"Notifies." Section 1-201.

"Seller." Section 2-103.

"Send." Section 1-201.

"Usage of trade." Section 1-205 [1-303].

§ 28-2-505. Seller's shipment under reservation. — (1) Where the seller has identified goods to the contract by or before shipment:

(a) his procurement of a negotiable bill of lading to his own order or otherwise reserves in him a security interest in the goods. His procurement of the bill to the order of a financing agency or of the buyer indicates in addition only the seller's expectation of transferring that interest to the person named.

(b) a nonnegotiable bill of lading to himself or his nominee reserves possession of the goods as security but except in a case of conditional delivery (subsection (2) of section 28-2-507[, Idaho Code]) a nonnegotiable bill of lading naming the buyer as consignee reserves no security interest even though the seller retains possession or control of the bill of lading.

(2) When shipment by the seller with reservation of a security interest is in violation of the contract for sale it constitutes an improper contract for transportation within the preceding section but impairs neither the rights given to the buyer by shipment and identification of the goods to the contract nor the seller's powers as a holder of a negotiable document of title.

History.

1967, ch. 161, § 2-505, p. 351; am. 2004, ch. 42, § 10, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in paragraph (1)(b) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 489 et seq.

Official Comment

Prior Uniform Statutory Provision: Section 20(2), (3), (4), Uniform Sales Act.

Changes: Completely rephrased, the "powers" of the parties in cases of reservation being emphasized primarily rather than the "rightfulness" of reservation.

Purposes of Changes: To continue in general the policy of the prior uniform statutory provision with certain modifications of emphasis and language, so that: 1. The security interest reserved to the seller under subsection (1) is restricted to securing payment or performance by the buyer and the seller is strictly limited in his disposition and control of the goods as against the buyer and third parties. Under this Article [Chapter], the provision as to the passing of interest expressly applies "despite any reservation of security title" and also provides that the "rights, obligations and remedies" of the parties are not altered by the incidence of title generally. The security interest, therefore, must be regarded as a means given to the seller to enforce his rights against the buyer which is unaffected by and in turn does not affect the location of title generally. The rules set forth in subsection (1) are not to be altered by any apparent "contrary intent" of the parties as to passing of title, since the rights and remedies of the parties to the contract of sale, as defined in this Article [Chapter], rest on the contract and its performance or breach and not on stereotyped presumptions as to the location of title.

This Article [Chapter] does not attempt to regulate local procedure in regard to the effective maintenance of the seller's security interest when the action is in replevin by the buyer against the carrier.

2. Every shipment of identified goods under a negotiable bill of lading reserves a security interest in the seller under subsection (1) paragraph (a).

It is frequently convenient for the seller to make the bill of lading to the order of a nominee such as his agent at destination, the financing agency to which he expects to negotiate the document or the bank issuing a credit to him. In many instances, also, the buyer is made the order party. This Article [Chapter] does not deal directly with the question as to whether a bill of lading made out by the seller to the order of a nominee gives the carrier

notice of any rights which the nominee may have so as to limit its freedom or obligation to honor the bill of lading in the hands of the seller as the original shipper if the expected negotiation fails. This is dealt with in the Article [Chapter] on Documents of Title (Article [Chapter] 7).

3. A nonnegotiable bill of lading taken to a party other than the buyer under subsection (1) paragraph (b) reserves possession of the goods as security in the seller but if he seeks to withhold the goods improperly the buyer can tender payment and recover them.

4. In the case of a shipment by nonnegotiable bill of lading taken to a buyer, the seller, under subsection (1) retains no security interest or possession as against the buyer and by the shipment he de facto loses control as against the carrier except where he rightfully and effectively stops delivery in transit. In cases in which the contract gives the seller the right to payment against delivery, the seller, by making an immediate demand for payment, can show that his delivery is conditional, but this does not prevent the buyer's power to transfer full title to a sub-buyer in ordinary course or other purchaser under Section 2-403.

5. Under subsection (2) an improper reservation by the seller which would constitute a breach in no way impairs such of the buyer's rights as result from identification of the goods. The security title reserved by the seller under subsection (1) does not protect his retaining possession or control of the document or the goods for the purpose of exacting more than is due him under the contract.

Cross References: Point 1: Section 1-201.

Point 2: Article [Chapter] 7.

Point 3: Sections 2-501(2) and 2-504.

Point 4: Sections 2-403, 2-507(2) and 2-705.

Point 5: Sections 2-310, 2-319(4), 2-320(4), 2-501 and 2-502 and Article [Chapter] 7.

Definitional Cross References: "Bill of lading." Section 1-201.

"Buyer." Section 2-103.

"Consignee." Section 7-102.

“Contract.” Section 1-201.

“Contract for sale.” Section 2-106.

“Delivery.” Section 1-201.

“Financing agency.” Section 2-104.

“Goods.” Section 2-105.

“Holder.” Section 1-201.

“Person.” Section 1-201.

“Security interest.” Section 1-201.

“Seller.” Section 2-103.

§ 28-2-506. Rights of financing agency. — (1) A financing agency by paying or purchasing for value a draft which relates to a shipment of goods acquires to the extent of the payment or purchase and in addition to its own rights under the draft and any document of title securing it any rights of the shipper in the goods including the right to stop delivery and the shipper's right to have the draft honored by the buyer.

(2) The right to reimbursement of a financing agency which has in good faith honored or purchased the draft under commitment to or authority from the buyer is not impaired by subsequent discovery of defects with reference to any relevant document which was apparently regular.

History.

1967, ch. 161, § 2-506, p. 351; am. 2004, ch. 42, § 11, p. 77.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. "Financing agency" is broadly defined in this Article [Chapter] to cover every normal instance in which a party aids or intervenes in the financing of a sales transaction. The term as used in subsection (1) is not in any sense intended as a limitation and covers any other appropriate situation which may arise outside the scope of the definition.

2. "Paying" as used in subsection (1) is typified by the letter of credit, or "authority to pay" situation in which a banker, by arrangement with the buyer or other consignee, pays on his behalf a draft for the price of the goods. It is immaterial whether the draft is formally drawn on the party paying or his principal, whether it is a sight draft paid in cash or a time draft "paid" in the first instance by acceptance, or whether the payment is viewed as absolute or conditional. All of these cases constitute "payment" under this subsection. Similarly, "purchasing for value" is used to indicate the whole area of financing by the seller's banker, and the principle of subsection (1) is applicable without any niceties of distinction between "purchase," "discount," "advance against collection" or the like. But it is important to notice that the only right to have the draft honored that is

acquired is that against the buyer; if any right against any one else is claimed it will have to be under some separate obligation of that other person. A letter of credit does not necessarily protect purchasers of drafts. See Article [Chapter] 5. And for the relations of the parties to documentary drafts see Part 5 of Article [Chapter] 4.

3. Subsection (1) is made applicable to payments or advances against a draft which “relates to” a shipment of goods and this has been chosen as a term of maximum breadth. In particular the term is intended to cover the case of a draft against an invoice or against a delivery order. Further, it is unnecessary that there be an explicit assignment of the invoice attached to the draft to bring the transaction within the reason of this subsection.

4. After shipment, “the rights of the shipper in the goods” are merely security rights and are subject to the buyer’s right to force delivery upon tender of the price. The rights acquired by the financing agency are similarly limited and, moreover, if the agency fails to procure any outstanding negotiable document of title, it may find its exercise of these rights hampered or even defeated by the seller’s disposition of the document to a third party. This section does not attempt to create any new rights in the financing agency against the carrier which would force the latter to honor a stop order from the agency, a stranger to the shipment, or any new rights against a holder to whom a document of title has been duly negotiated under Article [Chapter] 7.

5. The definition of the language “on its face” from subsection (2) is designed to accommodate electronic documents of title without changing the requirement of regularity of the document.

Cross References: Point 1: Section 2-104(2) and Article [Chapter] 4.

Point 2: Part 5 of Article [Chapter] 4, and Article [Chapter] 5.

Point 4: Sections 2-501 and 2-502(1) and Article [Chapter] 7.

Definitional Cross References: “Buyer.” Section 2-103.

“Document of title.” Section 1-201.

“Draft.” Section 3-104.

“Financing agency.” Section 2-104.

"Good faith." Section 2-103.

"Goods." Section 2-105.

"Honor." Section 1-201.

"Purchase." Section 1-201.

"Rights." Section 1-201.

"Value." Section 1-201 [now 1-204].

§ 28-2-507. Effect of seller's tender — Delivery on condition. — (1) Tender of delivery is a condition to the buyer's duty to accept the goods and, unless otherwise agreed, to his duty to pay for them. Tender entitles the seller to acceptance of the goods and to payment according to the contract.

(2) Where payment is due and demanded on the delivery to the buyer of goods or documents of title, his right as against the seller to retain or dispose of them is conditional upon his making the payment due.

History.

1967, ch. 161, § 2-507, p. 351.

CASE NOTES

Subsequent bona fide purchaser.

Tender of specified documents.

Subsequent Bona Fide Purchaser.

Subsection (2) of this section conferred no rights on seller as against subsequent bona fide purchaser. Western Idaho Prod. Credit Ass'n v. Simplot Feed Lots, Inc., 106 Idaho 260, 678 P.2d 52 (1984).

Tender of Specified Documents.

The fact that a transaction was simple, or that the dispute concerned the failure to tender specified documents rather than a failure to deliver conforming goods, does not exempt a case from the UCC's provisions but, rather, the Code specifically provides that, where parties agree that tender requires the seller to deliver documents, the seller must tender all such documents in correct form, and tender of delivery is a condition to the buyer's duty to accept goods and to his duty to pay for them. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Cited In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987); Building Concepts, Ltd. v. Pickering, 114 Idaho 640, 759 P.2d 931 (Ct. App. 1988).

Decisions Under Prior Law

Cash Sale.

Where the buyer under a contract of sale was not entitled to possession until payment, the law presumes a cash sale, which is one where payment and delivery are concurrent. Western Seed Marketing Co. v. Pfost, 45 Idaho 340, 262 P. 514 (1927).

Conditional Delivery.

Where contract was delivered conditionally, until conditions had been met buyer was under no obligation to pay nor was delivery to carrier in pursuance of the contract a completion of the contract. Continental Jewelry Co. v. Ingelstrom, 43 Idaho 337, 252 P. 186 (1926).

Forfeiture of Lease.

In determining whether a sale of personalty by an Idaho mining lessee to the lessor failed to vest title on the ground that no delivery was made, upon forfeiture of the lease, it was the duty of the lessee to deliver the property, and the duty of the lessor to accept it. Walker v. Lightfoot, 124 F.2d 3 (9th Cir. 1941).

Inspection.

Inspection was to be made at the destination, and a reasonable time therefor was allowed. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Conceding that the buyer should examine goods and notify of rejection and rescission because of breach of warranty as soon as possible, the question of what was reasonable as to time and place was a jury question. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Requisite Quality.

If the contract for sale of peaches was for U.S. No. 1's, buyer was required to accept only peaches of such grade. Peck v. Nixon, 47 Idaho 675, 277 P. 1112 (1929); Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

What Constitutes Acceptance.

Where acts and conduct of buyer after delivery of goods were inconsistent with ownership in seller, it would be deemed acceptance. Gross Mfg. Co. v. Redfield, 48 Idaho 399, 282 P. 487 (1929); Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

Where buyer sold part of goods delivered in usual course of his business, there was acceptance of entire consignment, notwithstanding attempted return of balance. Gross Mfg. Co. v. Redfield, 48 Idaho 399, 282 P. 487 (1929); Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 489 et seq.

Official Comment

Prior Uniform Statutory Provision: See Sections 11, 41, 42, and 69, Uniform Sales Act.

Purposes: 1. Subsection (1) continues the policies of the prior uniform statutory provisions with respect to tender and delivery by the seller. Under this Article [Chapter] the same rules in these matters are applied to present sales and to contracts for sale. But the provisions of this subsection must be read within the framework of the other sections of this Article [Chapter] which bear upon the question of delivery and payment.

2. The "unless otherwise agreed" provision of subsection (1) is directed primarily to cases in which payment in advance has been promised or a letter of credit term has been included. Payment "according to the contract" contemplates immediate payment, payment at the end of an agreed credit term, payment by a time acceptance or the like. Under this Act, "contract"

means the total obligation in law which results from the parties' agreement including the effect of this Article [Chapter]. In this context, therefore, there must be considered the effect in law of such provisions as those on means and manner of payment and on failure of agreed means and manner of payment.

3. Subsection (2) deals with the effect of a conditional delivery by the seller and in such a situation makes the buyer's "right as against the seller" conditional upon payment. These words are used as words of limitation to conform with the policy set forth in the bona fide purchase sections of this Article. Should the seller after making such a conditional delivery fail to follow up his rights, the condition is waived. This subsection (2) codifies the cash seller's right of reclamation which is in the nature of a lien. There is no specific time limit for a cash seller to exercise the right of reclamation. However, the right will be defeated by delay causing prejudice to the buyer, waiver, estoppel, or ratification of the buyer's right to retain possession. Common law rules and precedents governing such principles are applicable (Section 1-103). If third parties are involved, Section 2-403(1) protects good faith purchasers. See PEB Commentary No. 1, dated March 10, 1990.

Cross References: Point 1: Sections 2-310, 2-503, 2-511, 2-601 and 2-711 to 2-713.

Point 2: Sections 1-201, 2-511 and 2-614.

Point 3: Sections 2-401, 2-403, and 2-702(1) (b).

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Delivery." Section 1-201.

"Document of title." Section 1-201.

"Goods." Section 2-105.

"Rights." Section 1-201.

"Seller." Section 2-103.

§ 28-2-508. Cure by seller of improper tender or delivery — Replacement. — (1) Where any tender or delivery by the seller is rejected because nonconforming and the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure and may then within the contract time make a conforming delivery.

(2) Where the buyer rejects a nonconforming tender which the seller had reasonable grounds to believe would be acceptable with or without money allowance the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender.

History.

1967, ch. 161, § 2-508, p. 351.

CASE NOTES

Cure After Acceptance.

A right to cure is relevant only when a buyer has rejected the goods prior to a formal acceptance. The UCC does not allow a seller the right to cure defects following a buyer's acceptance of the goods. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 489 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) permits a seller who has made a nonconforming tender in any case to make a conforming delivery within the contract time upon seasonable notification to the buyer. It applies even where the seller has taken back the nonconforming goods and refunded the purchase price. He may still make a good tender within the contract period.

The closer, however, it is to the contract date, the greater is the necessity for extreme promptness on the seller's part in notifying of his intention to cure, if such notification is to be "seasonable" under this subsection.

The rule of this subsection, moreover, is qualified by its underlying reasons. Thus if, after contracting for June delivery, a buyer later makes known to the seller his need for shipment early in the month and the seller ships accordingly, the "contract time" has been cut down by the supervening modification and the time for cure of tender must be referred to this modified time term.

2. Subsection (2) seeks to avoid injustice to the seller by reason of a surprise rejection by the buyer. However, the seller is not protected unless he had "reasonable grounds to believe" that the tender would be acceptable. Such reasonable grounds can lie in prior course of dealing, course of performance or usage of trade as well as in the particular circumstances surrounding the making of the contract. The seller is charged with commercial knowledge of any factors in a particular sales situation which require him to comply strictly with his obligations under the contract as, for example, strict conformity of documents in an overseas shipment or the sale of precision parts or chemicals for use in manufacture. Further, if the buyer gives notice either implicitly, as by a prior course of dealing involving rigorous inspections, or expressly, as by the deliberate inclusion of a "no replacement" clause in the contract, the seller is to be held to rigid compliance. If the clause appears in a "form" contract evidence that it is out of line with trade usage or the prior course of dealing and was not called to the seller's attention may be sufficient to show that the seller had reasonable grounds to believe that the tender would be acceptable.

3. The words "a further reasonable time to substitute a conforming tender" are intended as words of limitation to protect the buyer. What is a "reasonable time" depends upon the attending circumstances. Compare Section 2-511 on the comparable case of a seller's surprise demand for legal tender.

4. Existing trade usages permitting variations without rejection but with price allowance enter into the agreement itself as contractual limitations of remedy and are not covered by this section.

Cross References: Point 2: Section 2-302.

Point 3: Section 2-511.

Point 4: Sections 1-205 [1-303] and 2-721.

Definitional Cross References: “Buyer.” Section 2-103.

“Conforming.” Section 2-106.

“Contract.” Section 1-201.

“Money.” Section 1-201.

“Notifies.” Section 1-201.

“Reasonable time.” Section 1-204 [1-205].

“Seasonably.” Section 1-204 [1-205].

“Seller.” Section 2-103.

§ 28-2-509. Risk of loss in the absence of breach. — (1) Where the contract requires or authorizes the seller to ship the goods by carrier

(a) if it does not require him to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are duly delivered to the carrier even though the shipment is under reservation (section 28-2-505[, Idaho Code]); but (b) if it does require him to deliver them at a particular destination and the goods are there duly tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there duly so tendered as to enable the buyer to take delivery.

(2) Where the goods are held by a bailee to be delivered without being moved, the risk of loss passes to the buyer (a) on his receipt of possession or control of a negotiable document of title covering the goods; or (b) on acknowledgment by the bailee of the buyer's right to possession of the goods; or (c) after his receipt of possession or control of a nonnegotiable document of title or other direction to deliver in a record, as provided in subsection (4)(b) of section 28-2-503[, Idaho Code].

(3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on his receipt of the goods if the seller is a merchant; otherwise the risk passes to the buyer on tender of delivery.

(4) The provisions of this section are subject to contrary agreement of the parties and to the provisions of this chapter on sale on approval (section 28-2-327[, Idaho Code]) and on effect of breach on risk of loss (section 28-2-510[, Idaho Code]).

History.

1967, ch. 161, § 2-509, p. 351; am. 2004, ch. 42, § 12, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in paragraphs (1)(a) and (2)(c) and subsection (4) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Cited In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 507 et seq.

ALR. — Who bears risk of loss of goods under UCC §§ 2-509, 2-510. 56 A.L.R.3d 145.

Official Comment

Prior Uniform Statutory Provision: Section 22, Uniform Sales Act.

Changes: Rewritten, subsection (3) of this section modifying prior law.

Purposes of Changes: To make it clear that: 1. The underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the "property" in the goods. The scope of the present section, therefore, is limited strictly to those cases where there has been no breach by the seller. Where for any reason his delivery or tender fails to conform to the contract, the present section does not apply and the situation is governed by the provisions on effect of breach on risk of loss.

2. The provisions of subsection (1) apply where the contract "requires or authorizes" shipment of the goods. This language is intended to be construed parallel to comparable language in the section on shipment by seller. In order that the goods be "duly delivered to the carrier" under paragraph (a) a contract must be entered into with the carrier which will satisfy the requirements of the section on shipment by the seller and the delivery must be made under circumstances which will enable the seller to take any further steps necessary to a due tender. The underlying reason of this subsection does not require that the shipment be made after contracting, but where, for example, the seller buys the goods afloat and later diverts the shipment to the buyer, he must identify the goods to the contract before the

risk of loss can pass. To transfer the risk it is enough that a proper shipment and a proper identification come to apply to the same goods although, aside from special agreement the risk will not pass retroactively to the time of shipment in such a case.

3. Whether the contract involves delivery at the seller's place of business or at the situs of the goods, a merchant seller cannot transfer risk of loss and it remains upon him until actual receipt by the buyer, even though full payment has been made and the buyer has been notified that the goods are at his disposal. Protection is afforded him, in the event of breach by the buyer, under the next section.

The underlying theory of this rule is that a merchant who is to make physical delivery at his own place continues meanwhile to control the goods and can be expected to insure his interest in them. The buyer, on the other hand, has no control of the goods and it is extremely unlikely that he will carry insurance on goods not yet in his possession.

4. Where the agreement provides for delivery of the goods as between the buyer and seller without removal from the physical possession of a bailee, the provisions on manner of tender of delivery apply on the point of transfer of risk. Due delivery of a negotiable document of title covering the goods or acknowledgment by the bailee that he holds for the buyer completes the "delivery" and passes the risk. See definition of delivery in Article 1, Section 1-201 and the definition of control in Article 7, Section 7-106.

5. The provisions of this section are made subject by subsection (4) to the "contrary agreement" of the parties. This language is intended as the equivalent of the phrase "unless otherwise agreed" used more frequently throughout this Act. "Contrary" is in no way used as a word of limitation and the buyer and seller are left free to readjust their rights and risks as declared by this section in any manner agreeable to them. Contrary agreement can also be found in the circumstances of the case, a trade usage or practice, or a course of dealing or performance.

Cross References: Point 1: Section 2-510(1).

Point 2: Sections 2-503 and 2-504.

Point 3: Sections 2-104, 2-503 and 2-510.

Point 4: Section 2-503(4).

Point 5: Section 1-201.

Definitional Cross References: "Agreement." Section 1-201.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Delivery." Section 1-201.

"Document of title." Section 1-201.

"Goods." Section 2-105.

"Merchant." Section 2-104.

"Party." Section 1-201.

"Receipt" of goods. Section 2-103.

"Sale on approval." Section 2-326.

"Seller." Section 2-103.

§ 28-2-510. Effect of breach on risk of loss. — (1) Where a tender or delivery of goods so fails to conform to the contract as to give a right of rejection the risk of their loss remains on the seller until cure or acceptance.

(2) Where the buyer rightfully revokes acceptance he may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as having rested on the seller from the beginning.

(3) Where the buyer as to conforming goods already identified to the contract for sale repudiates or is otherwise in breach before risk of their loss has passed to him, the seller may to the extent of any deficiency in his effective insurance coverage treat the risk of loss as resting on the buyer for a commercially reasonable time.

History.

1967, ch. 161, § 2-510, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 378 et seq.

ALR. — Who bears risk of loss of goods under UCC §§ 2-509, 2-510. 56 A.L.R.3d 145.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: To make clear that: 1. Under subsection (1) the seller by his individual action cannot shift the risk of loss to the buyer unless his action conforms with all the conditions resting on him under the contract.

2. The "cure" of defective tenders contemplated by subsection (1) applies only to those situations in which the seller makes changes in goods already tendered, such as repair, partial substitution, sorting out from an improper mixture and the like since "cure" by repossession and new tender has no effect on the risk of loss of the goods originally tendered. The seller's

privilege of cure does not shift the risk, however, until the cure is completed.

Where defective documents are involved a cure of the defect by the seller or a waiver of the defects by the buyer will operate to shift the risk under this section. However, if the goods have been destroyed prior to the cure or the buyer is unaware of their destruction at the time he waives the defect in the documents, the risk of the loss must still be borne by the seller, for the risk shifts only at the time of cure, waiver of documentary defects or acceptance of the goods.

3. In cases where there has been a breach of the contract, if the one in control of the goods is the aggrieved party, whatever loss or damage may prove to be uncovered by his insurance falls upon the contract breaker under subsections (2) and (3) rather than upon him. The word "effective" as applied to insurance coverage in those subsections is used to meet the case of supervening insolvency of the insurer. The "deficiency" referred to in the text means such deficiency in the insurance coverage as exists without subrogation. This section merely distributes the risk of loss as stated and is not intended to be disturbed by any subrogation of an insurer.

Cross Reference: Section 2-509.

Definitional Cross References: "Buyer." Section 2-103.

"Conform." Section 2-106.

"Contract for sale." Section 2-106.

"Goods." Section 2-105.

"Seller." Section 2-103.

§ 28-2-511. Tender of payment by buyer — Payment by check. — (1) Unless otherwise agreed tender of payment is a condition to the seller's duty to tender and complete any delivery.

(2) Tender of payment is sufficient when made by any means or in any manner current in the ordinary course of business unless the seller demands payment in legal tender and gives any extension of time reasonably necessary to procure it.

(3) Subject to the provisions of this act on the effect of an instrument on an obligation (section 28-3-310[, Idaho Code]), payment by check is conditional and is defeated as between the parties by dishonor of the check on due presentment.

History.

1967, ch. 161, § 2-511, p. 351; am. 1993, ch. 288, § 51, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The term "this act" in subsection (3) refers to S.L. 1967, ch. 161, which is compiled generally in chapters 1 to 10, title 28, Idaho Code. The reference probably should be to the entire Uniform Commercial Code.

The bracketed insertion near the middle of subsection (3) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

Section 54 of S.L. 1993, ch. 288 read: "Rights and obligations that arose under Chapter 6, Title 28, Idaho Code, and Section 28-9-111, Idaho Code, before their repeal remain valid and may be enforced as though those statutes had not been repealed."

CASE NOTES

Cash Sales.

Where debtor's sight draft was dishonored three days after debtor took possession of automobile and seller made demand for return within ten days after transfer of possession and dishonor as required by § 28-2-702, seller was entitled to return of automobile, even though debtor retained possession for almost three months before he filed bankruptcy. A sight draft is equivalent to a check and such a sale was a cash sale instead of a credit sale, so that the provisions of this section applied. Swayne v. Idaho Auto Auction (In re Shoemaker), 4 Bankr. 505 (Bankr. D. Idaho 1980).

Cited Se/Tnor Iguana's, Inc. v. Idaho State Police Bureau of Alcohol Bev. Control, 160 Idaho 290, 371 P.3d 344 (2016).

Decisions Under Prior Law

Cash Sales.

Where the buyer under a contract of sale was not entitled to possession until payment, the law presumes a cash sale, which is one where payment and delivery are concurrent. Western Seed Marketing Co. v. Pfost, 45 Idaho 340, 262 P. 514 (1927).

Official Comment

Prior Uniform Statutory Provision: Section 42, Uniform Sales Act.

Changes: Rewritten by this section and Section 2-507.

Purposes of Changes: 1. The requirement of payment against delivery in subsection (1) is applicable to non-commercial sales generally and to ordinary sales at retail although it has no application to the great body of commercial contracts which carry credit terms. Subsection (1) applies also to documentary contracts in general and to contracts which look to shipment by the seller but contain no term on time and manner of payment, in which situations the payment may, in proper case, be demanded against delivery of appropriate documents.

In the case of specific transactions such as C.O.D. sales or agreements providing for payment against documents, the provisions of this subsection must be considered in conjunction with the special sections of the Article [Chapter] dealing with such terms. The provision that tender of payment is a condition to the seller's duty to tender and complete "any delivery"

integrates this section with the language and policy of the section on delivery in several lots which call for separate payment. Finally, attention should be directed to the provision on right to adequate assurance of performance which recognizes, even before the time for tender, an obligation on the buyer not to impair the seller's expectation of receiving payment in due course.

2. Unless there is agreement otherwise the concurrence of the conditions as to tender of payment and tender of delivery requires their performance at a single place or time. This Article [Chapter] determines that place and time by determining in various other sections the place and time for tender of delivery under various circumstances and in particular types of transactions. The sections dealing with time and place of delivery together with the section on right to inspection of goods answer the subsidiary question as to when payment may be demanded before inspection by the buyer.

3. The essence of the principle involved in subsection (2) is avoidance of commercial surprise at the time of performance. The section on substituted performance covers the peculiar case in which legal tender is not available to the commercial community.

4. Subsection (3) is concerned with the rights and obligations as between the parties to a sales transaction when payment is made by check. This Article [Chapter] recognizes that the taking of a seemingly solvent party's check is commercially normal and proper and, if due diligence is exercised in collection, is not to be penalized in any way. The conditional character of the payment under this section refers only to the effect of the transaction "as between the parties" thereto and does not purport to cut into the law of "absolute" and "conditional" payment as applied to such other problems as the discharge of sureties or the responsibilities of a drawee bank which is at the same time an agent for collection.

The phrase "by check" includes not only the buyer's own but any check which does not effect a discharge under Article [Chapter] 3 (section 3-802). Similarly the reason of this subsection should apply and the same result should be reached where the buyer "pays" by sight draft on a commercial firm which is financing him.

5. Under subsection (3) payment by check is defeated if it is not honored upon due presentment. This corresponds to the provisions of article

[chapter] on Commercial Paper. (Section 3-802.) But if the seller procures certification of the check instead of cashing it, the buyer is discharged. (Section 3-411).

6. Where the instrument offered by the buyer is not a payment but a credit instrument such as a note or a check postdated by even one day, the seller's acceptance of the instrument insofar as third parties are concerned, amounts to a delivery on credit and his remedies are set forth in the section on buyer's insolvency. As between the buyer and the seller, however, the matter turns on the present subsection and the section on conditional delivery and subsequent dishonor of the instrument gives the seller rights on it as well as for breach of the contract for sale.

Cross References: Point 1: Sections 2-307, 2-310, 2-320, 2-325, 2-503, 2-513 and 2-609.

Point 2: Sections 2-307, 2-310, 2-319, 2-322, 2-503, 2-504 and 2-513.

Point 3: Section 2-614.

Point 5: Article [Chapter] 3, esp. Sections 3-802 and 3-411.

Point 6: Sections 2-507, 2-702, and Article [Chapter] 3.

Definitional Cross References: "Buyer." Section 2-103.

"Check." Section 3-104.

"Dishonor." Section 3-508.

"Party." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Seller." Section 2-103.

§ 28-2-512. Payment by buyer before inspection. — (1) Where the contract requires payment before inspection nonconformity of the goods does not excuse the buyer from so making payment unless

(a) the nonconformity appears without inspection; or (b) despite tender of the required documents the circumstances would justify injunction against honor under the provisions of this act (section 28-5-109(2)[, Idaho Code]).

(2) Payment pursuant to subsection (1) does not constitute an acceptance of goods or impair the buyer's right to inspect or any of his remedies.

History.

1967, ch. 161, § 2-512, p. 351; am. 1996, ch. 7, § 4, p. 9.

STATUTORY NOTES

Compiler's Notes.

The term "this act" near the end of paragraph (1)(b) refers to S.L. 1967, ch. 161, which is compiled generally in chapters 1 to 10, title 28, Idaho Code. The reference probably should be to the entire Uniform Commercial Code.

The bracketed insertion at the end of paragraph (1)(b) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Decisions Under Prior Law

Question for Jury.

Where buyer of peaches diverted shipment being made to Laramie, Wyo., to Chicago, Ill., without examining the peaches, the question as to what was reasonable as to time and place for buyer to examine peaches and notify seller of rejection of them for breach of warranty was for the jury. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Right to Examine Goods.

Inspection of goods by buyer was to be made at destination before sale was completed, and a reasonable time therefor was allowed. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 560 et seq.

Official Comment

Prior Uniform Statutory Provision: None, but see Sections 47 and 49, Uniform Sales Act.

Purposes: 1. Subsection (1) of the present section recognizes that the essence of a contract providing for payment before inspection is the intention of the parties to shift to the buyer the risks which would usually rest upon the seller. The basic nature of the transaction is thus preserved and the buyer is in most cases required to pay first and litigate as to any defects later.

2. "Inspection" under this section is an inspection in a manner reasonable for detecting defects in goods whose surface appearance is satisfactory.

3. Clause (a) of this subsection states an exception to the general rule based on common sense and normal commercial practice. The apparent nonconformity referred to is one which is evident in the mere process of taking delivery.

4. Clause (b) is concerned with contracts for payment against documents and incorporates the general clarification and modification of the case law contained in the section on excuse of a financing agency. Section 5-114.

5. Subsection (2) makes explicit the general policy of the Uniform Sales Act that the payment required before inspection in no way impairs the

buyer's remedies or rights in the event of a default by the seller. The remedies preserved to the buyer are all of his remedies, which include as a matter of reason the remedy for total non-delivery after payment in advance.

The provision on performance or acceptance under reservation of rights does not apply to the situations contemplated here in which payment is made in due course under the contract and the buyer need not pay "under protest" or the like in order to preserve his rights as to defects discovered upon inspection.

6. This section applies to cases in which the contract requires payment before inspection either by the express agreement of the parties or by reason of the effect in law of that contract. The present section must therefore be considered in conjunction with the provision on right to inspection of goods which sets forth the instances in which the buyer is not entitled to inspection before payment.

Cross References: Point 4: Article [Chapter] 5.

Point 5: Section 1-207.

Point 6: Section 2-513(3).

Definitional Cross References: "Buyer." Section 2-103.

"Conform." Section 2-106.

"Contract." Section 1-201.

"Financing agency." Section 2-104.

"Goods." Section 2-105.

"Remedy." Section 1-201.

"Rights." Section 1-201.

§ 28-2-513. Buyer's right to inspection of goods. — (1) Unless otherwise agreed and subject to subsection (3), where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner. When the seller is required or authorized to send the goods to the buyer, the inspection may be after their arrival.

(2) Expenses of inspection must be borne by the buyer but may be recovered from the seller if the goods do not conform and are rejected.

(3) Unless otherwise agreed and subject to the provisions of this chapter on C.I.F. contracts (subsection (3) of section 28-2-321[, Idaho Code]), the buyer is not entitled to inspect the goods before payment of the price when the contract provides (a) for delivery "C.O.D." or on other like terms; or (b) for payment against documents of title, except where such payment is due only after the goods are to become available for inspection.

(4) A place or method of inspection fixed by the parties is presumed to be exclusive but unless otherwise expressly agreed it does not postpone identification or shift the place for delivery or for passing the risk of loss. If compliance becomes impossible, inspection shall be as provided in this section unless the place or method fixed was clearly intended as an indispensable condition failure of which avoids the contract.

History.

1967, ch. 161, § 2-513, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in the introductory paragraph in subsection (3) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Inspection after storage.

Notification of rejection.

Inspection After Storage.

Where provisions of contract established that delivery of potatoes was to occur when the potatoes came out of storage, the method and manner of inspection could be established by the contract under subsection (4) of this section, so that inspection by government inspector as contemplated by parties during nine days following potatoes coming out of storage was prompt inspection under § 28-2-606, despite fact that buyer had opportunity to inspect potatoes before they went into storage; moreover, buyer's rejection of entire crop on the first working day following the last date of inspection was within reasonable time under § 28-2-602. G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

Notification of Rejection.

Buyer's notification of seller that the clay did not appear to be of the required quality did not operate as a rejection of the material but rather as an expression that the goods were nonconforming; notice of rejection of the clay was not made until buyer later sufficiently notified seller of his intent and of the need for seller to cure or remove the goods. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

The trial court erred when it found that the rejection was not made within a reasonable time after delivery where, although buyer might have waited until it could find replacement clay from an alternative supplier before rejecting, testing of the clay supplied had continued until it was shown that the supplied clay was nonconforming. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Decisions Under Prior Law

Question for jury.

Right to examine goods.

Question for Jury.

Where buyer of peaches diverted shipment being made to Laramie, Wyo., to Chicago, Ill., without examining the peaches, the question as to what was reasonable as to time and place for buyer to examine peaches and notify seller of rejection of them for breach of warranty was for the jury. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Right to Examine Goods.

Inspection of goods by buyer was to be made at destination before sale was completed, and a reasonable time therefor was allowed. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 560 et seq.

Official Comment

Prior Uniform Statutory Provision: Section 47(2), (3), Uniform Sales Act.

Changes: Rewritten, Subsections (2) and (3) being new.

Purposes of Changes and New Matter: To correspond in substance with the prior uniform statutory provision and to incorporate in addition some of the results of the better case law so that: 1. The buyer is entitled to inspect goods as provided in subsection (1) unless it has been otherwise agreed by the parties. The phrase "unless otherwise agreed" is intended principally to cover such situations as those outlined in subsections (3) and (4) and those in which the agreement of the parties negates inspection before tender of delivery. However, no agreement by the parties can displace the entire right of inspection except where the contract is simply for the sale of "this thing." Even in a sale of boxed goods "as is" inspection is a right of the buyer, since if the boxes prove to contain some other merchandise altogether the price can be recovered back; nor do the limitations of the provision on effect of acceptance apply in such a case.

2. The buyer's right of inspection is available to him upon tender, delivery or appropriation of the goods with notice to him. Since inspection is available to him on tender, where payment is due against delivery he may,

unless otherwise agreed, make his inspection before payment of the price. It is also available to him after receipt of the goods and so may be postponed after receipt for a reasonable time. Failure to inspect before payment does not impair the right to inspect after receipt of the goods unless the case falls within subsection (4) on agreed and exclusive inspection provisions. The right to inspect goods which have been appropriated with notice to the buyer holds whether or not the sale was by sample.

3. The buyer may exercise his right of inspection at any reasonable time or place and in any reasonable manner. It is not necessary that he select the most appropriate time, place or manner to inspect or that his selection be the customary one in the trade or locality. Any reasonable time, place or manner is available to him and the reasonableness will be determined by trade usages, past practices between the parties and the other circumstances of the case.

The last sentence of subsection (1) makes it clear that the place of arrival of shipped goods is a reasonable place for their inspection.

4. Expenses of an inspection made to satisfy the buyer of the seller's performance must be assumed by the buyer in the first instance. Since the rule provides merely for an allocation of expense there is no policy to prevent the parties from providing otherwise in the agreement. Where the buyer would normally bear the expenses of the inspection but the goods are rightly rejected because of what the inspection reveals, demonstrable and reasonable costs of the inspection are part of his incidental damage caused by the seller's breach.

5. In the case of payment against documents, subsection (3) requires payment before inspection, since shipping documents against which payment is to be made will commonly be tendered while the goods are still in transit. This Article [Chapter] recognizes no exception in any peculiar case in which the goods happen to arrive before the documents are tendered. However, where by the agreement payment is to await the arrival of the goods, inspection before payment becomes proper since the goods are then "available for inspection."

Where by the agreement the documents are to be tendered after arrival of the goods, the buyer is entitled to inspect before payment since the goods are then "available for inspection." Proof of usage is not necessary to

establish this right, but if inspection before payment is disputed the contrary must be established by usage or by an explicit contract term to that effect.

For the same reason, that the goods are available for inspection, a term calling for payment against storage documents or a delivery order does not normally bar the buyer's right to inspection before payment under subsection (3) (b). This result is reinforced by the buyer's right under subsection (1) to inspect goods which have been appropriated with notice to him.

6. Under subsection (4) an agreed place or method of inspection is generally held to be intended as exclusive. However, where compliance with such an agreed inspection term becomes impossible, the question is basically one of intention. If the parties clearly intend that the method of inspection named is to be a necessary condition without which the entire deal is to fail, the contract is at an end if that method becomes impossible. On the other hand, if the parties merely seek to indicate a convenient and reliable method but do not intend to give up the deal in the event of its failure, any reasonable method of inspection may be substituted under this Article [Chapter].

Since the purpose of an agreed place of inspection is only to make sure at that point whether or not the goods will be thrown back, the "exclusive" feature of the named place is satisfied under this Article [Chapter] if the buyer's failure to inspect there is held to be an acceptance with the knowledge of such defects as inspection would have revealed within the section on waiver of buyer's objections by failure to particularize. Revocation of the acceptance is limited to the situations stated in the section pertaining to that subject. The reasonable time within which to give notice of defects within the section on notice of breach begins to run from the point of the "acceptance."

7. Clauses on time of inspection are commonly clauses which limit the time in which the buyer must inspect and give notice of defects. Such clauses are therefore governed by the section of this Article [Chapter] which requires that such a time limitation must be reasonable.

8. Inspection under this Article [Chapter] is not to be regarded as a "condition precedent to the passing of title" so that risk until inspection remains on the seller. Under subsection (4) such an approach cannot be

sustained. Issues between the buyer and seller are settled in this Article [Chapter] almost wholly by special provisions and not by the technical determination of the locus of the title. Thus "inspection as a condition to the passing of title" becomes a concept almost without meaning. However, in peculiar circumstances inspection may still have some of the consequences hitherto sought and obtained under that concept.

9. "Inspection" under this section has to do with the buyer's check-up on whether the seller's performance is in accordance with a contract previously made and is not to be confused with the "examination" of the goods or of a sample or model of them at the time of contracting which may affect the warranties involved in the contract.

Cross References: Generally: Sections 2-310(b), 2-321(3) and 2-606(1)(b).

Point 1: Section 2-607.

Point 2: Sections 2-501 and 2-502.

Point 4: Section 2-715.

Point 5: Section 2-321(3).

Point 6: Sections 2-606 to 2-608.

Point 7: Section 1-204 [1-205].

Point 8: Comment to Section 2-401.

Point 9: Section 2-316(3)(b).

Definitional Cross References: "Buyer." Section 2-103.

"Conform." Section 2-106.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Document of title." Section 1-201.

"Goods." Section 2-105.

"Party." Section 1-201.

"Presumed." Section 1-201.

“Reasonable time.” Section 1-204 [1-205].

“Rights.” Section 1-201.

“Seller.” Section 2-103.

“Send.” Section 1-201.

“Term.” Section 1-201.

§ 28-2-514. When documents deliverable on acceptance — When on payment. — Unless otherwise agreed documents against which a draft is drawn are to be delivered to the drawee on acceptance of the draft if it is payable more than three (3) days after presentment; otherwise, only on payment.

History.

1967, ch. 161, § 2-514, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 489 et seq.

Official Comment

Prior Uniform Statutory Provision: Section 41, Uniform Bills of Lading Act.

Changes: Rewritten.

Purposes of Changes: To make the provision one of general application so that: 1. It covers any document against which a draft may be drawn, whatever may be the form of the document, and applies to interpret the action of a seller or consignor insofar as it may affect the rights and duties of any buyer, consignee or financing agency concerned with the paper. Supplementary or corresponding provisions are found in Sections 4-503 and 5-112.

2. An "arrival" draft is a sight draft within the purpose of this section.

Cross References: Point 1: See sections 2-502, 2-505(2), 2-507(2), 2-512, 2-513, 2-607 concerning protection of rights of buyer and seller, and 4-503 and 5-112 on delivery of documents.

Definitional Cross References: "Delivery." Section 1-201.

"Draft." Section 3-104.

§ 28-2-515. Preserving evidence of goods in dispute. — In furtherance of the adjustment of any claim or dispute

(a) either party on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence has the right to inspect, test and sample the goods including such of them as may be in the possession or control of the other; and (b) the parties may agree to a third party inspection or survey to determine the conformity or condition of the goods and may agree that the findings shall be binding upon them in any subsequent litigation or adjustment.

History.

1967, ch. 161, § 2-515, p. 351.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. To meet certain serious problems which arise when there is a dispute as to the quality of the goods and thereby perhaps to aid the parties in reaching a settlement, and to further the use of devices which will promote certainty as to the condition of the goods, or at least aid in preserving evidence of their condition.

2. Under paragraph (a), to afford either party an opportunity for preserving evidence, whether or not agreement has been reached, and thereby to reduce uncertainty in any litigation and, in turn perhaps, to promote agreement.

Paragraph (a) does not conflict with the provisions on the seller's right to resell rejected goods or the buyer's similar right. Apparent conflict between these provisions which will be suggested in certain circumstances is to be resolved by requiring prompt action by the parties. Nor does paragraph (a) impair the effect of a term for payment before inspection. Short of such defects as amount to fraud or substantial failure of consideration, non-conformity is neither an excuse nor a defense to an action for non-acceptance of documents. Normally, therefore, until the buyer has made

payment, inspected and rejected the goods, there is no occasion or use for the rights under paragraph (a).

3. Under paragraph (b), to provide for third party inspection upon the agreement of the parties, thereby opening the door to amicable adjustments based upon the findings of such third parties.

The use of the phrase "conformity or condition" makes it clear that the parties' agreement may range from a complete settlement of all aspects of the dispute by a third party to the use of a third party merely to determine and record the condition of the goods so that they can be resold or used to reduce the stake in controversy. "Conformity," at one end of the scale of possible issues, includes the whole question of interpretation of the agreement and its legal effect, the state of the goods in regard to quality and condition, whether any defects are due to factors which operate at the risk of the buyer, and the degree of non-conformity where that may be material. "Condition," at the other end of the scale, includes nothing but the degree of damage or deterioration which the goods show. Paragraph (b) is intended to reach any point in the gamut which the parties may agree upon.

The principle of the section on reservation of rights reinforces this paragraph in simplifying such adjustments as the parties wish to make in partial settlement while reserving their rights as to any further points. Paragraph (b) also suggests the use of arbitration, where desired, of any points left open, but nothing in this section is intended to repeal or amend any statute governing arbitration. Where any question arises as to the extent of the parties' agreement under the paragraph, the presumption should be that it was meant to extend only to the relation between the contract description and the goods as delivered, since that is what a craftsman in the trade would normally be expected to report upon. Finally, a written and authenticated report of inspection or tests by a third party, whether or not sampling has been practicable, is entitled to be admitted as evidence under this Act, for it is a third party document.

Cross References: Point 2: Sections 2-513(3), 2-706 and 2-711(2) and Article [Chapter] 5.

Point 3: Sections 1-202 and 1-207.

Definitional Cross References: "Conform." Section 2-106.

"Goods." Section 2-105.

"Notification." Section 1-201.

"Party." Section 1-201.

Part 6
Breach, Repudiation and Excuse

Idaho Code § 28-2-601

§ 28-2-601. Buyer's rights on improper delivery. — Subject to the provisions of this chapter on breach in installment contracts (section 28-2-612[, Idaho Code]) and unless otherwise agreed under the sections on contractual limitations of remedy (sections 28-2-718 and 28-2-719[, Idaho Code]), if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may

(a) reject the whole; or

(b) accept the whole; or

(c) accept any commercial unit or units and reject the rest.

History.

1967, ch. 161, § 2-601, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Right of rejection.

Acceptance of Any Commercial Unit.

Where all potatoes failed to conform to contract but buyer paid for 14 loads of potatoes which had been inspected in accordance with common practice of paying for inspected potatoes in order to keep the goodwill of the growers, this partial acceptance did not constitute the total acceptance of all of the crop since a buyer can accept any commercial units and reject the rest as long as he pays the contract price for the units accepted under § 28-2-607, even though acceptance of some units is an act inconsistent with the seller's ownership under § 28-2-606. G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

Buyer's Duty to Accept Goods.

The fact that a transaction was simple, or that the dispute concerned the failure to tender specified documents rather than a failure to deliver conforming goods, does not exempt a case from the UCC's provisions. Rather, the Code specifically provides that where parties agree that tender requires the seller to deliver documents, the seller must tender all such documents in correct form, and tender of delivery is a condition to the buyer's duty to accept goods and to his duty to pay for them. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Mitigation.

A buyer may use goods without accepting them, if the use is a reasonable attempt to mitigate damages. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Partial Acceptance.

Where buyer used 34 tons of the clay, approximately three and one-half per cent of the whole order, for testing and in noncritical areas, this use did not amount to acceptance of the whole. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Where there was no evidence that buyer's use of 34 tons of delivered clay produced an adverse effect on the remainder of the clay, on the quality of the product or its resale value, buyer accepted only the 34 tons it used

and the use did not constitute acceptance. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Rejection of Goods.

Buyer's notification of seller that the clay did not appear to be of the required quality did not operate as a rejection of the material but rather as an expression that the goods were nonconforming; notice of rejection of the clay was not made until buyer later sufficiently notified seller of his intent and of the need for seller to cure or remove the goods. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Athletic club owners' rejection of a dehumidifier occurred within a reasonable time after delivery, because they needed to operate the dehumidifier in the athletic club to determine whether it conformed to the express warranty and it was fit for that particular purpose. Their continued use of the dehumidifier was necessary to mitigate damages and was not an act inconsistent with the corporation's ownership. Keller v. Inland Metals All Weather Conditioning, Inc., 139 Idaho 233, 76 P.3d 977 (2003).

Right of Rejection.

Under contract for sale of potatoes which provided that contract would become void if potatoes were unfit for fresh pack shipping, those potatoes which did not make the fresh pack grade due to a "hollow hear" defect did not conform to the contract and gave buyer the right of rejection. Borges v. Magic Valley Foods, Inc., 101 Idaho 494, 616 P.2d 273 (1980).

Where, based upon the clear language of the contract and usage of trade, a buyer had the right to designate the fields from which an order of onions came and the seller attempted to deliver onions that were not from the designated fields, the buyer rightfully rejected the nonconforming goods under subsection (a). Panike & Sons Farms, Inc. v. Smith, 147 Idaho 562, 212 P.3d 992 (2009).

Cited Peckham v. Larsen Chevrolet-Buick-Oldsmobile, Inc., 99 Idaho 675, 587 P.2d 816 (1978).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 570 et seq.

C.J.S. — 77A C.J.S., Sales, § 324 et seq.

ALR. — Acceptance of some commercial unit of goods purchased under UCC § 2-601(C). 41 A.L.R.4th 396.

Official Comment

Prior Uniform Statutory Provision: No one general equivalent provision but numerous provisions, dealing with situations of nonconformity where buyer may accept or reject, including Sections 11, 44 and 69(1), Uniform Sales Act.

Changes: Partial acceptance in good faith is recognized and the buyer's remedies on the contract for breach of warranty and the like, where the buyer has returned the goods after transfer of title, are no longer barred.

Purposes of Changes: To make it clear that: 1. A buyer accepting a nonconforming tender is not penalized by the loss of any remedy otherwise open to him. This policy extends to cover and regulate the acceptance of a part of any lot improperly tendered in any case where the price can reasonably be apportioned. Partial acceptance is permitted whether the part of the goods accepted conforms or not. The only limitation on partial acceptance is that good faith and commercial reasonableness must be used to avoid undue impairment of the value of the remaining portion of the goods. This is the reason for the insistence on the "commercial unit" in paragraph (c). In this respect, the test is not only what unit has been the basis of contract, but whether the partial acceptance produces so materially adverse an effect on the remainder as to constitute bad faith.

2. Acceptance made with the knowledge of the other party is final. An original refusal to accept may be withdrawn by a later acceptance if the seller has indicated that he is holding the tender open. However, if the buyer attempts to accept, either in whole or in part, after his original rejection has caused the seller to arrange for other disposition of the goods, the buyer must answer for any ensuing damage since the next section provides that any exercise of ownership after rejection is wrongful as against the seller. Further, he is liable even though the seller may choose to treat his action as acceptance rather than conversion, since the damage flows from the misleading notice. Such arrangements for resale or other disposition of the goods by the seller must be viewed as within the normal contemplation of a

buyer who has given notice of rejection. However, the buyer's attempts in good faith to dispose of defective goods where the seller has failed to give instructions within a reasonable time are not to be regarded as an acceptance.

Cross References: Sections 2-602(2)(a), 2-612, 2-718 and 2-719.

Definitional Cross References: "Buyer." Section 2-103.

"Commercial unit." Section 2-105.

"Conform." Section 2-106.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Installment contract." Section 2-612.

"Rights." Section 1-201.

§ 28-2-602. Manner and effect of rightful rejection. — (1) Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller.

(2) Subject to the provisions of the two following sections on rejected goods (sections 28-2-603 and 28-2-604[, Idaho Code]), (a) after rejection any exercise of ownership by the buyer with respect to any commercial unit is wrongful as against the seller; and (b) if the buyer has before rejection taken physical possession of goods in which he does not have a security interest under the provisions of this chapter (subsection (3) of section 28-2-711[, Idaho Code]), he is under a duty after rejection to hold them with reasonable care at the seller's disposition for a time sufficient to permit the seller to remove them; but (c) the buyer has no further obligations with regard to goods rightfully rejected.

(3) The seller's rights with respect to goods wrongfully rejected are governed by the provisions of this chapter on seller's remedies in general (section 28-2-703[, Idaho Code]).

History.

1967, ch. 161, § 2-602, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in the introductory paragraph in subsection (2), in paragraph (2)(b), and in subsection (3) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Notification of Rejection.

Buyer's notification of seller that the clay did not appear to be of the required quality did not operate as a rejection of the material but rather as an expression that the goods were nonconforming; notice of rejection of the clay was not made until buyer later sufficiently notified seller of his intent and of the need for seller to cure or remove the goods. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Rejection Within Reasonable Time.

Where provisions of contract established that delivery of potatoes was to occur when the potatoes came out of storage, the method and manner of inspection could be established by the contract under subsection (4) of § 28-2-513, so that inspection by government inspector as contemplated by parties during nine days following potatoes coming out of storage was prompt inspection under § 28-2-606, despite fact that buyer had opportunity to inspect potatoes before they went into storage. Buyer's rejection of entire crop on the first working day following the last date of inspection was within reasonable time under this section. G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

Athletic club owners' rejection of a dehumidifier occurred within a reasonable time after delivery, because they needed to operate the dehumidifier in the athletic club to determine whether it conformed to the express warranty and that it was fit for that particular purpose. Their continued use of the dehumidifier was necessary to mitigate damages and was not an act inconsistent with the corporation's ownership. Keller v. Inland Metals All Weather Conditioning, Inc., 139 Idaho 233, 76 P.3d 977 (2003).

Cited Peckham v. Larsen Chevrolet-Buick-Oldsmobile, Inc., 99 Idaho 675, 587 P.2d 816 (1978); Pittsley v. Houser, 125 Idaho 820, 875 P.2d 232 (Ct. App. 1994).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 570 et seq.

Official Comment

Prior Uniform Statutory Provision: Section 50, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that: 1. A tender or delivery of goods made pursuant to a contract of sale, even though wholly nonconforming, requires affirmative action by the buyer to avoid acceptance. Under subsection (1), therefore, the buyer is given a reasonable time to notify the seller of his rejection, but without such seasonable notification his rejection is ineffective. The sections of this Article [Chapter] dealing with inspection of goods must be read in connection with the buyer's reasonable time for action under this subsection. Contract provisions limiting the time for rejection fall within the rule of the section on "Time" and are effective if the time set gives the buyer a reasonable time for discovery of defects. What constitutes a due "notifying" of rejection by the buyer to the seller is defined in Section 1-201.

2. Subsection (2) lays down the normal duties of the buyer upon rejection, which flow from the relationship of the parties. Beyond his duty to hold the goods with reasonable care for the buyer's [seller's] disposition, this section continues the policy of prior uniform legislation in generally relieving the buyer from any duties with respect to them, except when the circumstances impose the limited obligation of salvage upon him under the next section.

3. The present section applies only to rightful rejection by the buyer. If the seller has made a tender which in all respects conforms to the contract, the buyer has a positive duty to accept and his failure to do so constitutes a "wrongful rejection" which gives the seller immediate remedies for breach. Subsection (3) is included here to emphasize the sharp distinction between the rejection of an improper tender and the non-acceptance which is a breach by the buyer.

4. The provisions of this section are to be appropriately limited or modified when a negotiation is in process.

Cross References: Point 1: Sections 1-201, 1-204 [1-205](1) and (3), 2-512(2), 2-513(1) and 2-606(1)(b).

Point 2: Section 2-603(1).

Point 3: Section 2-703.

Definitional Cross References: "Buyer." Section 2-103.

"Commercial unit." Section 2-105.

"Goods." Section 2-105.

"Merchant." Section 2-104.

"Notifies." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Remedy." Section 1-201.

"Rights." Section 1-201.

"Seasonably." Section 1-204 [1-205].

"Security interest." Section 1-201.

"Seller." Section 2-103.

§ 28-2-603. Merchant buyer's duties as to rightfully rejected goods. —

(1) Subject to any security interest in the buyer (subsection (3) of section 28-2-711[, Idaho Code]), when the seller has no agent or place of business at the market of rejection a merchant buyer is under a duty after rejection of goods in his possession or control to follow any reasonable instructions received from the seller with respect to the goods and in the absence of such instructions to make reasonable efforts to sell them for the seller's account if they are perishable or threaten to decline in value speedily. Instructions are not reasonable if on demand indemnity for expenses is not forthcoming.

(2) When the buyer sells goods under subsection (1), he is entitled to reimbursement from the seller or out of the proceeds for reasonable expenses of caring for and selling them, and if the expenses include no selling commission then to such commission as is usual in the trade or if there is none to a reasonable sum not exceeding ten per cent (10%) on the gross proceeds.

(3) In complying with this section the buyer is held only to good faith and good faith conduct hereunder is neither acceptance nor conversion nor the basis of an action for damages.

History.

1967, ch. 161, § 2-603, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion near the beginning of subsection (1) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Duty to resell.

Reasonable instructions.

Duty to Resell.

The duty to resell under this section is triggered by an absence of instructions from a seller. Borges v. Magic Valley Foods, Inc., 101 Idaho 494, 616 P.2d 273 (1980).

Reasonable Instructions.

Where potatoes did not conform to sales contract and buyer and seller agreed to blend defective potatoes with higher-grade potatoes to reach acceptable grade but such attempt was unsuccessful, the jury could have reasonably found that seller's instructions were only to blend the potatoes in hope of accomplishing fresh pack grade and that buyer's processing of the potatoes into flakes and subsequent resale thereof was a precipitate action taken before the lapse of a reasonable time within which respondents could give further instructions or, even if a reasonable time had elapsed, thus permitting buyer to resell the potatoes, the jury could have concluded that processing of the potatoes by buyer was an acceptance rather than a resale; accordingly, verdict holding buyer responsible for full contract price was affirmed. Borges v. Magic Valley Foods, Inc., 101 Idaho 494, 616 P.2d 273 (1980).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 570 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. This section recognizes the duty imposed upon the merchant buyer by good faith and commercial practice to follow any reasonable instructions of the seller as to reshipping, storing, delivery to a third party, reselling or the like. Subsection (1) goes further and extends the duty to include the making of reasonable efforts to effect a salvage sale where the value of the goods is threatened and the seller's instructions do not arrive in time to prevent serious loss.

2. The limitations on the buyer's duty to resell under subsection (1) are to be liberally construed. The buyer's duty to resell under this section arises from commercial necessity and thus is present only when the seller has "no agent or place of business at the market of rejection." A financing agency which is acting in behalf of the seller in handling the documents rejected by the buyer is sufficiently the seller's agent to lift the burden of salvage resale from the buyer. (See provisions of Sections 4-503 and 5-112 on bank's duties with respect to rejected documents.) The buyer's duty to resell is extended only to goods in his "possession or control," but these are intended as words of wide, rather than narrow, import. In effect, the measure of the buyer's "control" is whether he can practicably effect control without undue commercial burden.

3. The explicit provisions for reimbursement and compensation to the buyer in subsection (2) are applicable and necessary only where he is not acting under instructions from the seller. As provided in subsection (1) the seller's instructions to be "reasonable" must on demand of the buyer include indemnity for expenses.

4. Since this section makes the resale of perishable goods an affirmative duty in contrast to a mere right to sell as under the case law, subsection (3) makes it clear that the buyer is liable only for the exercise of good faith in determining whether the value of the goods is sufficiently threatened to justify a quick resale or whether he has waited a sufficient length of time for instructions, or what a reasonable means and place of resale is.

5. A buyer who fails to make a salvage sale when his duty to do so under this section has arisen is subject to damages pursuant to the section on liberal administration of remedies.

Cross References: Point 2: Sections 4-503 and 5-112.

Point 5: Section 1-106. Compare generally section 2-706.

Definitional Cross References: "Buyer." Section 2-103.

"Good faith." Section 1-201.

"Goods." Section 2-105.

"Merchant." Section 2-104.

"Security interest." Section 1-201.

“Seller.” Section 2-103.

§ 28-2-604. Buyer's options as to salvage of rightfully rejected goods. — Subject to the provisions of the immediately preceding section on perishables if the seller gives no instructions within a reasonable time after notification of rejection the buyer may store the rejected goods for the seller's account or reship them to him or resell them for the seller's account with reimbursement as provided in the preceding section. Such action is not acceptance or conversion.

History.

1967, ch. 161, § 2-604, p. 351.

CASE NOTES

Processing of Potatoes.

Where potatoes did not conform to sales contract and buyer and seller agreed to blend defective potatoes with higher-grade potatoes to reach acceptable grade but such attempt was unsuccessful, the jury could have reasonably found that seller's instructions were only to blend the potatoes in hope of accomplishing fresh pack grade and that buyer's processing of the potatoes into flakes and subsequent resale thereof was a precipitate action taken before the lapse of a reasonable time within which respondents could give further instructions or, even if a reasonable time had elapsed, thus permitting buyer to resell the potatoes, the jury could have concluded that processing of the potatoes by buyer was an acceptance rather than a resale; accordingly, verdict holding buyer responsible for full contract price was affirmed. Borges v. Magic Valley Foods, Inc., 101 Idaho 494, 616 P.2d 273 (1980).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 570 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: The basic purpose of this section is twofold: on the one hand it aims at reducing the stake in dispute and on the other at avoiding the pinning of a technical "acceptance" on a buyer who has taken steps towards realization on or preservation of the goods in good faith. This section is essentially a salvage section and the buyer's right to act under it is conditioned upon (1) non-conformity of the goods, (2) due notification of rejection to the seller under the section on manner of rejection, and (3) the absence of any instructions from the seller which the merchant-buyer has a duty to follow under the preceding section.

This section is designed to accord all reasonable leeway to a rightfully rejecting buyer acting in good faith. The listing of what the buyer may do in the absence of instructions from the seller is intended to be not exhaustive but merely illustrative. This is not a "merchant's" section and the options are pure options given to merchant and non-merchant buyers alike. The merchant-buyer, however, may in some instances be under a duty rather than an option to resell under the provisions of the preceding section.

Cross References: Sections 2-602(1), and 2-603(1) and 2-706.

Definitional Cross References: "Buyer." Section 2-103.

"Notification." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Seller." Section 2-103.

§ 28-2-605. Waiver of buyer's objections by failure to particularize. —

(1) The buyer's failure to state in connection with rejection a particular defect which is ascertainable by reasonable inspection precludes him from relying on the unstated defect to justify rejection or to establish breach

(a) where the seller could have cured it if stated seasonably; or (b) between merchants when the seller has after rejection made a request in writing for a full and final written statement of all defects on which the buyer proposes to rely.

(2) Payment against documents made without reservation of rights precludes recovery of the payment for defects apparent in the documents.

History.

1967, ch. 161, § 2-605, p. 351; am. 2004, ch. 42, § 13, p. 77.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 570 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. The present section rests upon a policy of permitting the buyer to give a quick and informal notice of defects in a tender without penalizing him for omissions in his statement, while at the same time protecting a seller who is reasonably misled by the buyer's failure to state curable defects.

2. Where the defect in a tender is one which could have been cured by the seller, a buyer who merely rejects the delivery without stating his objections to it is probably acting in commercial bad faith and seeking to get out of a deal which has become unprofitable. Subsection (1) (a), following the general policy of this Article [Chapter] which looks to preserving the deal wherever possible, therefore insists that the seller's right to correct his tender in such circumstances be protected.

3. When the time for cure is past, subsection (1) (b) makes it plain that a seller is entitled upon request to a final statement of objections upon which he can rely. What is needed is that he make clear to the buyer exactly what is being sought. A formal demand under paragraph (b) will be sufficient in the case of a merchant-buyer.

4. Subsection (2) applies to the particular case of documents the same principle which the section on effects of acceptance applies to the case of goods. The matter is dealt with in this section in terms of "waiver" of objections rather than of right to revoke acceptance, partly to avoid any confusion with the problems of acceptance of goods and partly because defects in documents which are not taken as grounds for rejection are generally minor ones. The only defects concerned in the present subsection are defects in the documents which are apparent. This rule applies to both tangible and electronic documents of title. Where payment is required against the documents they must be inspected before payment, and the payment then constitutes acceptance of the documents. Under the section dealing with this problem, such acceptance of the documents does not constitute an acceptance of the goods or impair any options or remedies of the buyer for their improper delivery. Where the documents are delivered without requiring such contemporary action as payment from the buyer, the reason of the next section on what constitutes acceptance of goods, applies. Their acceptance by non-objection is therefore postponed until after a reasonable time for their inspection. In either situation, however, the buyer "waives" only the defects apparent in the documents.

Cross References: Point 2: Section 2-508.

Point 4: Sections 2-512(2), 2-606(1) (b), 2-607(2).

Definitional Cross References: "Between merchants." Section 2-104.

"Buyer." Section 2-103.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

"Writing" and "written." Section 1-201.

§ 28-2-606. What constitutes acceptance of goods. — (1) Acceptance of goods occurs when the buyer

(a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their nonconformity; or

(b) fails to make an effective rejection (subsection (1) of section 28-2-602[, Idaho Code]), but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or

(c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

(2) Acceptance of a part of any commercial unit is acceptance of that entire unit.

History.

1967, ch. 161, § 2-606, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in paragraph (1)(b) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Use in mitigation.

Act Inconsistent with Ownership.

Where all potatoes failed to conform to contract but buyer paid for 14 loads of potatoes which had been inspected in accordance with common practice of paying for inspected potatoes in order to keep the goodwill of the growers, this partial acceptance did not constitute the total acceptance of all of the crop, since a buyer can accept any commercial units and reject the rest as long as he pays the contract price for the units accepted under § 28-2-607, even though acceptance of some units is an act inconsistent with the seller's ownership under this section. G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

District court properly entered a judgment in favor of a company in the grower's contract dispute arising from the development of bacterial ring rot in two of the potato varieties grown by the company for the grower because, inter alia, statutory recertification was not required by the contract, the grower's actions — selling some of the uninfected potatoes and making a payment to the company — were inconsistent with the company's ownership of the seed, as the grower's acceptance of the uninfected potatoes reinstated the contract Silver Creek Seed, LLC v. Sunrain Varieties, LLC, 161 Idaho 270, 385 P.3d 448 (2016).

Failure to Reject.

By commingling and failing to reject any deliveries, the defendant accepted all 23 loads of potatoes and was obligated to pay the contract price. Licklyey v. Max Herbold, Inc., 133 Idaho 209, 984 P.2d 697 (1999).

Partial Acceptance.

Where there was no evidence that buyer's use of 34 tons of delivered clay produced an adverse effect on the remainder of the clay, on the quality of the product, or its resale value, buyer accepted only the 34 tons it used and the use did not constitute acceptance. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Processing of Potatoes.

Where potatoes did not conform to sales contract and buyer and seller agreed to blend defective potatoes with higher-grade potatoes to reach

acceptable grade but such attempt was unsuccessful, the jury could have reasonably found that seller's instructions were only to blend the potatoes in hope of accomplishing fresh pack grade and that buyer's processing of the potatoes into flakes and subsequent resale thereof was a precipitate action taken before the lapse of a reasonable time within which respondents could give further instructions or, even if a reasonable time had elapsed thus permitting buyer to resell the potatoes, the jury could have concluded that processing of the potatoes by buyer was an acceptance rather than a resale; accordingly, verdict holding buyer responsible for full contract price was affirmed. Borges v. Magic Valley Foods, Inc., 101 Idaho 494, 616 P.2d 273 (1980).

Where there was no evidence presented of an attempt to resell defective potatoes in the bins to an independent third party, the potato buyer's processing and sale of the potatoes in the ordinary course of its own business (presumably for profit) was an act inconsistent with the seller's ownership and constituted an acceptance of the goods. Borges v. Magic Valley Foods, Inc., 101 Idaho 494, 616 P.2d 273 (1980).

Reasonable Opportunity to Inspect.

Where provisions of contract established that delivery of potatoes was to occur when the potatoes came out of storage, the method and manner of inspection could be established by the contract under subsection (4) of § 28-2-513, so that inspection by government inspector as contemplated by parties during nine days following potatoes coming out of storage was prompt inspection under this section, despite fact that buyer had opportunity to inspect potatoes before they went into storage. Buyer's rejection of entire crop on the first working day following the last date of inspection was within reasonable time under § 28-2-602. G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

The trial court erred when it found that the rejection was not made within a reasonable time after delivery where, although buyer might have waited until it could find replacement clay from an alternative supplier before rejecting, testing of the clay supplied had continued until it was shown that the supplied clay was nonconforming. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Where buyer used 34 tons of the clay, approximately three and one-half per cent of the whole order, for testing and in noncritical areas, this use did not amount to acceptance of the whole. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Receipt and Acceptance.

Receipt and acceptance of goods is deemed to constitute an unambiguous overt admission by both parties that a contract actually exists, and makes admissible oral evidence of other terms of the contract, and under the "receipt and acceptance" exception to the statute, a modified contract may be enforced to the extent of the goods that have been accepted. Thus, whether the implied agreement between building contractor and building supplies company regarding conditions of payment is viewed as modifying the terms of the parties' initial contract, or as an agreement to terminate the initial contract and create a new, "original" contract, its enforcement is not barred by the statute of frauds. Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Use in Mitigation.

A buyer may use goods without accepting them, if the use is a reasonable attempt to mitigate damages. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Cited Pittsley v. Houser, 125 Idaho 820, 875 P.2d 232 (Ct. App. 1994).

Decisions Under Prior Law

Acceptance as question of law or fact.

Acceptance of portion of consignment.

Seller's compliance with contract.

Acceptance as Question of Law or Fact.

Where buyer of peaches diverted shipment being made to Laramie, Wyo., to Chicago, Ill., without examining peaches, evidence presented question for jury as to whether buyer's failure to examine peaches at Laramie and reject them because of alleged breach of warranty constituted an "acceptance," so as to render buyer liable for contract price. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Where buyer of peaches promptly notified seller, after examining peaches, that it refused to accept peaches because they did not conform to contract and offered to return them or hold them for seller's disposition, evidence presented question for jury as to whether buyer's subsequent sale of peaches to another amounted to an "acceptance," so as to render buyer liable for contract price. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Acceptance of Portion of Consignment.

Where buyer sold part of goods delivered in usual course of his business, there was acceptance of entire consignment, notwithstanding attempted return of balance. Gross Mfg. Co. v. Redfield, 48 Idaho 399, 282 P. 487 (1929); Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

Letter written by buyer telling appellant that "he would return the rest as soon as he had time" at the same time remitting an additional $100 with statement "meanwhile find a check inclosed to be applied as agreed on equipment first purchased from you" showed that the return of the equipment would be at the buyer's convenience and that he regarded part of the equipment as having been purchased subject to payment of purchase price, all of which was inconsistent with ownership of seller. Mohr v. Schultz, 86 Idaho 531, 388 P.2d 1002 (1964).

Seller's Compliance with Contract.

In an action for the balance allegedly due for logs sold and delivered, it was not necessary to determine whether the seller complied fully with the terms of the contract with respect to the delivery where the buyer received the logs and appropriated them to his own use. Reynolds v. Blackwell Lumber Co., 61 Idaho 529, 104 P.2d 19 (1940).

Seller did not release his right to payment for the goods sold and delivered when he subsequently offered to accept their return and cancel the agreement with reference to remaking the agreement with reference to the condition of the equipment upon its return and the amount of rent "for its use during these many long months" inasmuch as parties did not arrive at an agreement, buyer being deemed to have used the equipment and an

obligation therefore existed to pay a reasonable value. Mohr v. Schultz, 86 Idaho 531, 388 P.2d 1002 (1964).

Where there was no language in correspondence between the parties to indicate that appellant regarded the mere promise to return the goods as sufficient to cancel the agreement between the parties, the converse being true, nor did appellant attempt to place respondent in status quo, since there was no showing of return of partial payments, there was no showing of good consideration supporting the agreement to receive in order for it to become an enforceable contract. Mohr v. Schultz, 86 Idaho 531, 388 P.2d 1002 (1964).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 570 et seq.

ALR. — Advertisement addressed to public relating to sale or purchase of goods at specified price as an offer the acceptance of which will consummate a contract. 43 A.L.R.3d 1102.

Use of goods by buyer as constituting acceptance under UCC § 2-606(1)(c). 67 A.L.R.3d 363.

Farmers as "merchants" within provisions of UCC Article 2, dealing with sales. 95 A.L.R.3d 484.

State lotteries: actions by ticketholders against state or contractor for state. 40 A.L.R.4th 662.

Private contests and lotteries: entrant's rights and remedies. 64 A.L.R.4th 1021.

Official Comment

Prior Uniform Statutory Provision: Section 48, Uniform Sales Act.

Changes: Rewritten, the qualification in paragraph (c) and subsection (2) being new; otherwise the general policy of the prior legislation is continued.

Purposes of Changes and New Matter: To make it clear that:

1. Under this Article [Chapter] "acceptance" as applied to goods means that the buyer, pursuant to the contract, takes particular goods which have

been appropriated to the contract as his own, whether or not he is obligated to do so, and whether he does so by words, action, or silence when it is time to speak. If the goods conform to the contract, acceptance amounts only to the performance by the buyer of one part of his legal obligation.

2. Under this Article [Chapter] acceptance of goods is always acceptance of identified goods which have been appropriated to the contract or are appropriated by the contract. There is no provision for “acceptance of title” apart from acceptance in general, since acceptance of title is not material under this Article [Chapter] to the detailed rights and duties of the parties. (See Section 2-401). The refinements of the older law between acceptance of goods and of title become unnecessary in view of the provisions of the sections on effect and revocation of acceptance, on effects of identification and on risk of loss, and those sections which free the seller’s and buyer’s remedies from the complications and confusions caused by the question of whether title has or has not passed to the buyer before breach.

3. Under paragraph (a), payment made after tender is always one circumstance tending to signify acceptance of the goods but in itself it can never be more than one circumstance and is not conclusive. Also, a conditional communication of acceptance always remains subject to its expressed conditions.

4. Under paragraph (c), any action taken by the buyer, which is inconsistent with his claim that he has rejected the goods, constitutes an acceptance. However, the provisions of paragraph (c) are subject to the sections dealing with rejection by the buyer which permit the buyer to take certain actions with respect to the goods pursuant to his options and duties imposed by those sections, without effecting an acceptance of the goods. The second clause of paragraph (c) modifies some of the prior case law and makes it clear that “acceptance” in law based on the wrongful act of the acceptor is acceptance only as against the wrongdoer and then only at the option of the party wronged.

In the same manner in which a buyer can bind himself, despite his insistence that he is rejecting or has rejected the goods, by an act inconsistent with the seller’s ownership under paragraph (c), he can obligate himself by a communication of acceptance despite a prior rejection under paragraph (a). However, the sections on buyer’s rights on improper delivery

and on the effect of rightful rejection, make it clear that after he once rejects a tender, paragraph (a) does not operate in favor of the buyer unless the seller has re-tendered the goods or has taken affirmative action indicating that he is holding the tender open. See also Comment 2 to Section 2-601.

5. Subsection (2) supplements the policy of the section on buyer's rights on improper delivery, recognizing the validity of a partial acceptance but insisting that the buyer exercise this right only as to whole commercial units.

Cross References: Point 2: Sections 2-401, 2-509, 2-510, 2-607, 2-608 and Part 7.

Point 4: Sections 2-601 through 2-604.

Point 5: Section 2-601.

Definitional Cross References: "Buyer." Section 2-103.

"Commercial unit." Section 2-105.

"Goods." Section 2-105.

"Seller." Section 2-103.

§ 28-2-607. Effect of acceptance — Notice of breach — Burden of establishing breach after acceptance — Notice of claim or litigation to person answerable over. — (1) The buyer must pay at the contract rate for any goods accepted.

(2) Acceptance of goods by the buyer precludes rejection of the goods accepted and if made with knowledge of a nonconformity cannot be revoked because of it unless the acceptance was on the reasonable assumption that the nonconformity would be seasonably cured but acceptance does not of itself impair any other remedy provided by this chapter for nonconformity.

(3) Where a tender has been accepted

(a) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy; and (b) if the claim is one for infringement or the like (subsection (3) of section 28-2-312[, Idaho Code]) and the buyer is sued as a result of such a breach he must so notify the seller within a reasonable time after he receives notice of the litigation or be barred from any remedy over for liability established by the litigation.

(4) The burden is on the buyer to establish any breach with respect to the goods accepted.

(5) Where the buyer is sued for breach of a warranty or other obligation for which his seller is answerable over (a) he may give his seller written notice of the litigation. If the notice states that the seller may come in and defend and that if the seller does not do so he will be bound in any action against him by his buyer by any determination of fact common to the two (2) litigations, then unless the seller after seasonable receipt of the notice does come in and defend he is so bound.

(b) if the claim is one for infringement or the like (subsection (3) of section 28-2-312[, Idaho Code]) the original seller may demand in writing that his buyer turn over to him control of the litigation including settlement or else be barred from any remedy over and if he also agrees to bear all expense and to satisfy any adverse judgment, then unless the

buyer after seasonable receipt of the demand does turn over control the buyer is so barred.

(6) The provisions of subsections (3), (4) and (5) apply to any obligation of a buyer to hold the seller harmless against infringement or the like (subsection (3) of section 28-2-312[, Idaho Code]).

History.

1967, ch. 161, § 2-607, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in paragraphs (3)(b) and (5)(b) and subsection (6) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Jury to State Theory for Award.

In an action on a counterclaim, where the jury was instructed on the elements necessary for recovery both for breach of contract and for fraud, but the verdict form failed to designate the theory upon which the defendant was entitled to relief, the trial court erred in failing to require the jury to state the theory upon which its award was based, since an award for breach of contract may have exceeded the limitations period imposed by paragraph (3)(a) of this section. Full Circle, Inc. v. Schelling, 108 Idaho 634, 701 P.2d 254 (Ct. App. 1985).

Liability for Full Contract Price.

Where potatoes did not conform to sales contract and buyer and seller agreed to blend defective potatoes with higher-grade potatoes to reach acceptable grade but such attempt was unsuccessful, the jury could have reasonably found that seller's instructions were only to blend the potatoes in hope of accomplishing fresh pack grade and that buyer's processing of the potatoes into flakes and subsequent resale thereof was a precipitate action taken before the lapse of a reasonable time within which respondents could give further instructions or, even if a reasonable time had elapsed, thus permitting buyer to resell the potatoes, the jury could have concluded that processing of the potatoes by buyer was an acceptance rather than a resale; accordingly, verdict holding buyer responsible for full contract price was affirmed. Borges v. Magic Valley Foods, Inc., 101 Idaho 494, 616 P.2d 273 (1980).

By commingling and failing to reject any deliveries, the defendant accepted all 23 loads of potatoes and was obligated to pay the contract price. Licklyey v. Max Herbold, Inc., 133 Idaho 209, 984 P.2d 697 (1999).

Nonconforming Goods.

In an action for breach of warranty in a sale of sheep, where the jury found for the seller, the trial judge did not abuse his discretion in granting the buyer's motion for a new trial on the ground that the verdict was inconsistent with the evidence, where the evidence showed the seller delivered less sheep than the contract amount, nine of the sheep were castrated males, some of the sheep were older than represented, some were infected with a disease causing abortions, and others did not bear lambs in the numbers anticipated. Murphy v. Etchegaray, 108 Idaho 814, 702 P.2d 852 (Ct. App. 1985).

Buyer could rightfully revoke acceptance given the nonconformity of the machine and seller's failure to remedy the damage. Beal v. Griffin, 123 Idaho 445, 849 P.2d 118 (Ct. App. 1993).

Notice of Breach.

The question of whether a buyer gave a seller notice within a reasonable time after the buyer knew or should have known of the breach of a sale agreement was a question for the jury, where reasonable minds might draw

different inferences from the probative facts. Full Circle, Inc. v. Schelling, 108 Idaho 634, 701 P.2d 254 (Ct. App. 1985).

In an action for breach of warranty in a sale of sheep, the question of whether the buyer notified the seller of the breach within a reasonable time, as required by subdivision (3)(a) of this section, where the buyer gave such notice six months after discovery of a disease causing abortion in a number of the sheep due to the four-month period of gestation of the sheep and the time required for veterinarians to establish reliable data, was a question for the jury. Murphy v. Etchegaray, 108 Idaho 814, 702 P.2d 852 (Ct. App. 1985).

Subdivision (3)(a) of this section does not require any particular form of communication, and, therefore, it was not fatal to plaintiff motel operator's claim where one year elapsed before written communication of a breach occurred, since when motel operator noticed problems with carpet that it purchased within two to three months of opening its motel, it then called the individual who arranged for the purchase of the carpet, who immediately inspected same and observed its unacceptable condition, and who then placed several inspection requests with the carpet manufacturer before receiving any response; under the circumstances of this case, the evidence supported a finding that notice was given within a reasonable time. Meldco, Inc. v. Hollytex Carpet Mills, Inc., 118 Idaho 265, 796 P.2d 142 (Ct. App. 1990).

Notice of Rejection.

Buyer's notification of seller that the clay did not appear to be of the required quality did not operate as a rejection of the material but rather as an expression that the goods were nonconforming; notice of rejection of the clay was not made until buyer later sufficiently notified seller of this intent and of the need for seller to cure or remove the goods. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Partial Acceptance.

Where all potatoes failed to conform to contract but buyer paid for 14 loads of potatoes which had been inspected in accordance with common practice of paying for inspected potatoes in order to keep the goodwill of the growers, this partial acceptance did not constitute the total acceptance of

all of the crop, since a buyer can accept any commercial units and reject the rest as long as he pays the contract price for the units accepted under this section, even though acceptance of some units is an act inconsistent with the seller's ownership under § 28-2-606. G & H Land & Cattle Co. v. Heitzman & Nelson, Inc., 102 Idaho 204, 628 P.2d 1038 (1981).

Cited Consolidated Supply Co. v. Babbitt, 96 Idaho 636, 534 P.2d 466 (1975); International Harvester Co. v. TRW, Inc., 107 Idaho 1123, 695 P.2d 1262 (1985); Hoff Companies, Inc. v. Danner, 121 Idaho 39, 822 P.2d 558 (Ct. App. 1991).

Decisions Under Prior Law

Amount of Damages.

In actions for fraud and actions for breach of warranty, the measure of damages was the difference between the price paid and the reasonable market value of the article at the time of sale, the purpose being to limit recovery to the loss actually sustained by the buyer, thus preventing recovery of speculative profits. Jesse M. Chase, Inc. v. Leonard, 69 Idaho 109, 203 P.2d 600 (1955).

In a complaint for breach of warranty in sale of explosives for use in excavation for sewer, an allegation "that plaintiff had to remove rock by mechanical means at a great expense to his damage" was not sufficient pleading of measure of damages. Coleman v. Carter, 77 Idaho 210, 289 P.2d 932 (1955).

Difference in Values.

If buyer elected to retain machine contracted for and bring an action for breach of warranty of quality, he was entitled to recover the difference between the value of the machine at the time of delivery to the buyer and the value the machine would have had if seller had answered to the

warranty, plus any special damages alleged and proved. Sanchotena v. Tower Co., 74 Idaho 541, 264 P.2d 1021 (1953).

In suit by buyer to recover damages for breach of warranty that pump purchased would produce specific amount of water for use of crops, the buyer was not entitled to a new trial on ground that jury failed to award him damages for difference in value of pump contracted for and value of pump delivered, where there was no evidence on value of pump. Sanchotena v. Tower Co., 74 Idaho 541, 264 P.2d 1021 (1953).

Implied Warranties.

Implied warranties for quality or fitness are coextensive. National Motor Serv. Co. v. Walters, 85 Idaho 349, 379 P.2d 643 (1963).

Notice of Breach of Warranty.

The failure of the purchaser to give notice of defects became unnecessary where it was admitted that the seller's agent who installed the machinery had notice of the defects and attempted to remedy them. W.H. Bintz Co. v. Mueggler, 65 Idaho 760, 154 P.2d 513 (1944).

Adequate notice of a breach of warranty under the Uniform Sales Act requires that the buyer do each of the following: refer to a particular sale in the notice; advise the seller of the alleged defect; refute any inference of waiver; and infer or directly assert that there is a violation of his legal rights, a claim which need not be an express claim of damages. Salmon Rivers Sportsman Camps, Inc. v. Cessna Aircraft Co., 97 Idaho 348, 544 P.2d 306 (1975).

Rescission.

Former statute, relating to remedies where buyer accepted goods, included in the phrase "other legal remedy" the buyer's right of rescission. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

RESEARCH REFERENCES

Am. Jur. 2d. — 17A Am. Jur. 2d, Contracts, § 590 et seq.

67 Am. Jur. 2d, Sales, § 570 et seq.

ALR. — Sufficiency and timeliness of buyer's notice under UCC § 2-607 of seller's breach of warranty. 93 A.L.R.3d 363.

Sufficiency and timeliness of buyer's notice under UCC § 607(3)(a) of seller's breach of warranty. 89 A.L.R.5th 319.

Official Comment

Prior Uniform Statutory Provision: Subsection (1)—Section 41, Uniform Sales Act; Subsections (2) and (3)—Sections 49 and 69, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue the prior basic policies with respect to acceptance of goods while making a number of minor though material changes in the interest of simplicity and commercial convenience so that: 1. Under subsection (1), once the buyer accepts a tender the seller acquires a right to its price on the contract terms. In cases of partial acceptance, the price of any part accepted is, if possible, to be reasonably apportioned, using the type of apportionment familiar to the courts in *quantum valebat* cases, to be determined in terms of "the contract rate," which is the rate determined from the bargain in fact (the agreement) after the rules and policies of this Article [Chapter] have been brought to bear.

2. Under subsection (2) acceptance of goods precludes their subsequent rejection. Any return of the goods thereafter must be by way of revocation of acceptance under the next section. Revocation is unavailable for a nonconformity known to the buyer at the time of acceptance, except where the buyer has accepted on the reasonable assumption that the nonconformity would be seasonably cured.

3. All other remedies of the buyer remain unimpaired under subsection (2). This is intended to include the buyer's full rights with respect to future installments despite his acceptance of any earlier nonconforming installment.

4. The time of notification is to be determined by applying commercial standards to a merchant buyer. "A reasonable time" for notification from a retail consumer is to be judged by different standards so that in his case it

will be extended, for the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy.

The content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched. There is no reason to require that the notification which saves the buyer's rights under this section must include a clear statement of all the objections that will be relied on by the buyer, as under the section covering statements of defects upon rejection (Section 2-605). Nor is there reason for requiring the notification to be a claim for damages or of any threatened litigation or other resort to a remedy. The notification which saves the buyer's rights under this Article [Chapter] need only be such as informs the seller that the transaction is claimed to involve a breach, and thus opens the way for normal settlement through negotiation.

5. Under this Article [Chapter] various beneficiaries are given rights for injuries sustained by them because of the seller's breach of warranty. Such a beneficiary does not fall within the reason of the present section in regard to discovery of defects and the giving of notice within a reasonable time after acceptance, since he has nothing to do with acceptance. However, the reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred. What is said above, with regard to the extended time for reasonable notification from the lay consumer after the injury is also applicable here; but even a beneficiary can be properly held to the use of good faith in notifying, once he has had time to become aware of the legal situation.

6. Subsection (4) unambiguously places the burden of proof to establish breach on the buyer after acceptance. However, this rule becomes one purely of procedure when the tender accepted was nonconforming and the buyer has given the seller notice of breach under subsection (3). For subsection (2) makes it clear that acceptance leaves unimpaired the buyer's right to be made whole, and that right can be exercised by the buyer not only by way of crossclaim for damages, but also by way of recoupment in diminution or extinction of the price.

7. Subsections (3)(b) and (5)(b) give a warrantor against infringement an opportunity to defend or compromise third-party claims or be relieved of his liability. Subsection (5) (a) codifies for all warranties the practice of

voucher to defend. Compare Section 3-803. Subsection (6) makes these provisions applicable to the buyer's liability for infringement under Section 2-312.

8. All of the provisions of the present section are subject to any explicit reservation of rights.

Cross References: Point 1: Section 1-201.

Point 2: Section 2-608.

Point 4: Sections 1-204 [1-205] and 2-605.

Point 5: Section 2-318.

Point 6: Section 2-717.

Point 7: Sections 2-312 and 3-803.

Point 8: Section 1-207.

Definitional Cross References: "Burden of establishing." Section 1-201.

"Buyer." Section 2-103.

"Conform." Section 2-106.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Notifies." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Remedy." Section 1-201.

"Seasonably." Section 1-204 [1-205].

§ 28-2-608. Revocation of acceptance in whole or in part. — (1) The buyer may revoke his acceptance of a lot or commercial unit whose nonconformity substantially impairs its value to him if he has accepted it

(a) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or (b) without discovery of such nonconformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

(2) Revocation of acceptance must occur within a reasonable time after the buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects. It is not effective until the buyer notifies the seller of it.

(3) A buyer who so revokes has the same rights and duties with regard to the goods involved as if he had rejected them.

History.

1967, ch. 161, § 2-608, p. 351.

CASE NOTES

Change in Condition.

Under subsection (2) of this section, evidence would support a jury finding that the changes which occurred in a mobile home after delivery to the buyers were caused by its own defects or by the attempts of seller to remedy the defects. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Cure.

A right to cure is relevant only when a buyer has rejected the goods prior to a formal acceptance and the UCC does not allow a seller the right to cure defects following a buyer's acceptance of the goods. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Although mobile home buyers notified seller of defects and attempted to obtain cures therefor, they thereby gave seller a right to cure only until they found his efforts to be unsatisfactory and such defects as were actually cured could not be utilized in the determination of whether value was substantially impaired by the defects; such holding rewarded seller for repairs which were promptly made, but also excluded from consideration attempted but unsuccessful repairs, improper repairs, planned but uncompleted repairs, etc., since such considerations are irrelevant under the UCC. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

In General.

Rescission and revocation of acceptance amount to the same thing under the Uniform Commercial Code, particularly since cancellation is a remedy available to a buyer who has established justifiable grounds for revocation of acceptance. Peckham v. Larsen Chevrolet-Buick-Oldsmobile, Inc., 99 Idaho 675, 587 P.2d 816 (1978).

Because a buyer may revoke acceptance only against the seller and because a finding that the purchasers had the right to revoke acceptance against automobile dealer is consistent with a finding that the dealer had not breached any warranties, jury verdict for purchasers was not inconsistent and was permissible on revocation claim against dealer and on the lemon law claim against automobile manufacturer. Griffith v. Latham Motors, Inc., 128 Idaho 356, 913 P.2d 572 (1996).

Latent Defects.

Section 28-2-725(2) provides that, where a warranty explicitly extends to future performance of goods, any breach of warranty occurs at the time of such performance. Thus, while a buyer has a duty to inspect goods at the time of delivery to find patent defects, he must be allowed a reasonable time after inspecting and accepting the goods to discover latent defects under this section. Where farmers alleged a breach of warranty due to a latent defect in feed supplement supplier's product — its propensity to turn acidic and, thus, be harmful to calves if not refrigerated — the defect could not have been found on inspection at delivery. Millenkamp v. Davisco Foods Int'l, Inc., 562 F.3d 971 (9th Cir. 2009).

Nonconforming Goods.

Buyer could rightfully revoke acceptance given the nonconformity of the machine and seller's failure to remedy the damage. Beal v. Griffin, 123 Idaho 445, 849 P.2d 118 (Ct. App. 1993).

Notice.

Where buyers of mobile home did not give a notice of "revocation" as such, but did give notice of rescission, such notice was not inadequate since a notice of rescission operates as notice of revocation of acceptance for the purpose of this section. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Remedy Unavailable.

Buyer of a used Jeep was not permitted to revoke his acceptance upon discovering that the Jeep previously sustained collision damage that was insufficiently repaired. Sale contract stated the dealership was to deliver the Jeep "as is," with all the faults it contained at the time of the sale. Haight v. Dale's Used Cars, Inc., 139 Idaho 853, 87 P.3d 962 (Ct. App. 2003).

Substantial Impairment.

The test of substantial impairment is subjective in that the test is whether the nonconformities substantially impaired the value of the home to the actual buyer and not whether the nonconformities substantially impaired the value of the home to a reasonable person. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Where buyers of mobile home sought to revoke acceptance, a two-step determination was required to resolve the question of the existence of substantial impairment, i.e., the court must first determine the purpose for which the buyers purchased the home and, secondly, determine whether the nonconformities substantially impaired their ability to use the home for the purpose intended. Where buyers purchased the home for use as a retirement residence, the jury must determine whether the defects in the home substantially impaired their ability to use the home for that purpose. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Buyers revoked their acceptance of used engine installed by mechanic where the record clearly showed that a defect in the engine substantially impaired its value and that the buyers retained possession of it while reasonably assuming that mechanic would repair the engine. Berning v. Drumwright, 122 Idaho 203, 832 P.2d 1138 (Ct. App. 1992).

Sufficiency of Revocation.

No particular form or content of notice of revocation of acceptance is required if the notice is sufficient to inform the seller that the buyer has revoked and to identify the particular goods as to which he has revoked. Peckham v. Larsen Chevrolet-Buick-Oldsmobile, Inc., 99 Idaho 675, 587 P.2d 816 (1978).

The jury could have found that the buyers of mobile home did revoke acceptance within a reasonable time after they discovered or should have discovered the grounds for revocation, regardless of their occupancy of the mobile home. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Acceptance of a used copy machine was revoked by the buyer where the defect in the copier substantially impaired its value and the buyer retained possession of it while reasonably assuming that the defect would be cured. Lee v. Peterson, 110 Idaho 601, 716 P.2d 1373 (Ct. App. 1986).

Cited Fernandez v. Western R.R. Bldrs., 112 Idaho 907, 736 P.2d 1361 (Ct. App. 1987); Pittsley v. Houser, 125 Idaho 820, 875 P.2d 232 (Ct. App. 1994); De Groot v. Standley Trenching, Inc., 157 Idaho 557, 338 P.3d 536 (2014).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 570 et seq.

ALR. — Time for revocation of acceptance of goods under UCC § 2-608(2). 65 A.L.R.3d 354.

Measure and elements of buyer's recovery upon revocation of acceptance of goods under UCC § 2-608(1). 65 A.L.R.3d 388.

Official Comment

Prior Uniform Statutory Provision: Section 69(1) (d), (3), (4) and (5), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that: 1. Although the prior basic policy is continued, the buyer is no longer required to elect between revocation of acceptance and recovery of damages for breach. Both are now available to him. The non-alternative character of the two remedies is stressed by the terms used in the present section. The section no longer speaks of "rescission," a term capable of ambiguous application either to transfer of title to the goods or to the contract of sale and susceptible also of confusion with cancellation for cause of an executed or executory portion of the contract. The remedy under this section is instead referred to simply as "revocation of acceptance" of goods tendered under a contract for sale and involves no suggestion of "election" of any sort.

2. Revocation of acceptance is possible only where the nonconformity substantially impairs the value of the goods to the buyer. For this purpose the test is not what the seller had reason to know at the time of contracting; the question is whether the nonconformity is such as will in fact cause a substantial impairment of value to the buyer though the seller had no advance knowledge as to the buyer's particular circumstances.

3. "Assurances" by the seller under paragraph (b) of subsection (1) can rest as well in the circumstances or in the contract as in explicit language used at the time of delivery. The reason for recognizing such assurances is that they induce the buyer to delay discovery. These are the only assurances involved in paragraph (b). Explicit assurances may be made either in good faith or bad faith. In either case any remedy accorded by this Article [Chapter] is available to the buyer under the section on remedies for fraud.

4. Subsection (2) requires notification of revocation of acceptance within a reasonable time after discovery of the grounds for such revocation. Since this remedy will be generally resorted to only after attempts at adjustment have failed, the reasonable time period should extend in most cases beyond the time in which notification of breach must be given, beyond the time for discovery of nonconformity after acceptance and beyond the time for rejection after tender. The parties may by their agreement limit the time for notification under this section, but the same sanctions and considerations apply to such agreements as are discussed in the comment on manner and effect of rightful rejection.

5. The content of the notice under subsection (2) is to be determined in this case as in others by considerations of good faith, prevention of surprise, and reasonable adjustment. More will generally be necessary than the mere notification of breach required under the preceding section. On the other hand the requirements of the section on waiver of buyer's objections do not apply here. The fact that quick notification of trouble is desirable affords good ground for being slow to bind a buyer by his first statement. Following the general policy of this Article [Chapter], the requirements of the content of notification are less stringent in the case of a non-merchant buyer.

6. Under subsection (2) the prior policy is continued of seeking substantial justice in regard to the condition of goods restored to the seller. Thus the buyer may not revoke his acceptance if the goods have materially deteriorated except by reason of their own defects. Worthless goods, however, need not be offered back and minor defects in the articles reoffered are to be disregarded.

7. The policy of the section allowing partial acceptance is carried over into the present section and the buyer may revoke his acceptance, in appropriate cases, as to the entire lot or any commercial unit thereof.

Cross References: Point 3: Section 2-721.

Point 4: Sections 1-204 [1-205], 2-602 and 2-607.

Point 5: Sections 2-605 and 2-607.

Point 7: Section 2-601.

Definitional Cross References: "Buyer." Section 2-103.

"Commercial unit." Section 2-105.

"Conform." Section 2-106.

"Goods." Section 2-105.

"Lot." Section 2-105.

"Notifies." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Rights." Section 1-201.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

§ 28-2-609. Right to adequate assurance of performance. — (1) A contract for sale imposes an obligation on each party that the other's expectation of receiving due performance will not be impaired. When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.

(2) Between merchants the reasonableness of grounds for insecurity and the adequacy of any assurance offered shall be determined according to commercial standards.

(3) Acceptance of any improper delivery or payment does not prejudice the aggrieved party's right to demand adequate assurance of future performance.

(4) After receipt of a justified demand failure to provide within a reasonable time not exceeding thirty (30) days such assurance of due performance as is adequate under the circumstances of the particular case is a repudiation of the contract.

History.

1967, ch. 161, § 2-609, p. 351.

CASE NOTES

Timely Demand.

Plaintiff failed to comply with this section where it began suspending its performance to pay months prior to seeking assurances that defendant would deliver, and, at the time plaintiff was seeking assurances, it had already received the potatoes for which payment was owed. Magic Valley Foods, Inc. v. Sun Valley Potatoes, Inc., 134 Idaho 785, 10 P.3d 734 (2000).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 473 et seq.

Official Comment

Prior Uniform Statutory Provision: See Sections 53, 54(1) (b), 55 and 63(2), Uniform Sales Act.

Purposes: 1. The section rests on the recognition of the fact that the essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit and that a continuing sense of reliance and security that the promised performance will be forthcoming when due, is an important feature of the bargain. If either the willingness or the ability of a party to perform declines materially between the time of contracting and the time for performance, the other party is threatened with the loss of a substantial part of what he has bargained for. A seller needs protection not merely against having to deliver on credit to a shaky buyer, but also against having to procure and manufacture the goods, perhaps turning down other customers. Once he has been given reason to believe that the buyer's performance has become uncertain, it is an undue hardship to force him to continue his own performance. Similarly, a buyer who believes that the seller's deliveries have become uncertain cannot safely wait for the due date of performance when he has been buying to assure himself of materials for his current manufacturing or to replenish his stock of merchandise.

2. Three measures have been adopted to meet the needs of commercial men in such situations. First, the aggrieved party is permitted to suspend his own performance and any preparation therefor, with excuse for any resulting necessary delay, until the situation has been clarified. "Suspend performance" under this section means to hold up performance pending the outcome of the demand, and includes also the holding up of any preparatory action. This is the same principle which governs the ancient law of stoppage and seller's lien, and also of excuse of a buyer from prepayment if the seller's actions manifest that he cannot or will not perform. (Original Act, Section 63(2).)

Secondly, the aggrieved party is given the right to require adequate assurance that the other party's performance will be duly forthcoming. This principle is reflected in the familiar clauses permitting the seller to curtail deliveries if the buyer's credit becomes impaired, which when held within

the limits of reasonableness and good faith actually express no more than the fair business meaning of any commercial contract.

Third, and finally, this section provides the means by which the aggrieved party may treat the contract as broken if his reasonable grounds for insecurity are not cleared up within a reasonable time. This is the principle underlying the law of anticipatory breach, whether by way of defective part performance or by repudiation. The present section merges these three principles of law and commercial practice into a single theory of general application to all sales agreements looking to future performance.

3. Subsection (2) of the present section requires that “reasonable” grounds and “adequate” assurance as used in subsection (1) be defined by commercial rather than legal standards. The express reference to commercial standards carries no connotation that the obligation of good faith is not equally applicable here.

Under commercial standards and in accord with commercial practice, a ground for insecurity need not arise from or be directly related to the contract in question. The law as to “dependence” or “independence” of promises within a single contract does not control the application of the present section.

Thus a buyer who falls behind in “his account” with the seller, even though the items involved have to do with separate and legally distinct contracts, impairs the seller’s expectation of due performance. Again, under the same test, a buyer who requires precision parts which he intends to use immediately upon delivery, may have reasonable grounds for insecurity if he discovers that his seller is making defective deliveries of such parts to other buyers with similar needs. Thus, too, in a situation such as arose in *Jay Dreher Corporation v. Delco Appliance Corporation*, 93 F.2d 275 (C.C.A.2, 1937), where a manufacturer gave a dealer an exclusive franchise for the sale of his product but on two or three occasions breached the exclusive dealing clause, although there was no default in orders, deliveries or payments under the separate sales contract between the parties, the aggrieved dealer would be entitled to suspend his performance of the contract for sale under the present section and to demand assurance that the exclusive dealing contract would be lived up to. There is no need for an

explicit clause tying the exclusive franchise into the contract for the sale of goods since the situation itself ties the agreements together.

The nature of the sales contract enters also into the question of reasonableness. For example, a report from an apparently trustworthy source that the seller had shipped defective goods or was planning to ship them would normally give the buyer reasonable grounds for insecurity. But when the buyer has assumed the risk of payment before inspection of the goods, as in a sales contract on C.I.F. or similar cash against documents terms, that risk is not to be evaded by a demand for assurance. Therefore no ground for insecurity would exist under this section unless the report went to a ground which would excuse payment by the buyer.

4. What constitutes "adequate" assurance of due performance is subject to the same test of factual conditions. For example, where the buyer can make use of a defective delivery, a mere promise by a seller of good repute that he is giving the matter his attention and that the defect will not be repeated, is normally sufficient. Under the same circumstances, however, a similar statement by a known corner-cutter might well be considered insufficient without the posting of a guaranty or, if so demanded by the buyer, a speedy replacement of the delivery involved. By the same token where a delivery has defects, even though easily curable, which interfere with easy use by the buyer, no verbal assurance can be deemed adequate which is not accompanied by replacement, repair, money-allowance, or other commercially reasonable cure.

A fact situation such as arose in *Corn Products Refining Co. v. Fasola*, 94 N.J.L. 181, 109 A. 505 (1920) offers illustration both of reasonable grounds for insecurity and "adequate" assurance. In that case a contract for the sale of oils on 30 days' credit, 2% off for payment within 10 days, provided that credit was to be extended to the buyer only if his financial responsibility was satisfactory to the seller. The buyer had been in the habit of taking advantage of the discount but at the same time that he failed to make his customary 10-day payment, the seller heard rumors, in fact false, that the buyer's financial condition was shaky. Thereupon, the seller demanded cash before shipment or security satisfactory to him. The buyer sent a good credit report from his banker, expressed willingness to make payments when due on the 30-day terms and insisted on further deliveries under the contract. Under this Article [Chapter] the rumors, although false, were

enough to make the buyer's financial condition "unsatisfactory" to the seller under the contract clause. Moreover, the buyer's practice of taking the cash discounts is enough, apart from the contract clause, to lay a commercial foundation for suspicion when the practice is suddenly stopped. These matters, however, go only to the justification of the seller's demand for security, or his "reasonable grounds for insecurity."

The adequacy of the assurance given is not measured as in the type of "satisfaction" situation affected with intangibles, such as in personal service cases, cases involving a third party's judgment as final, or cases in which the whole contract is dependent on one party's satisfaction, as in a sale on approval. Here, the seller must exercise good faith and observe commercial standards. This Article [Chapter] thus approves the statement of the court in *James B. Berry's Sons Co. of Illinois v. Monark Gasoline & Oil Co., Inc.*, 32 F.2d 74, (C.C.A.8, 1929), that the seller's satisfaction under such a clause must be based upon reason and must not be arbitrary or capricious; and rejects the purely personal "good faith" test of the *Corn Products Refining Co.* case, which held that in the seller's sole judgment, if for any reason he was dissatisfied, he was entitled to revoke the credit. In the absence of the buyer's failure to take the 2% discount as was his custom, the banker's report given in that case would have been "adequate" assurance under this Act, regardless of the language of the "satisfaction" clause. However, the seller is reasonably entitled to feel insecure at a sudden expansion of the buyer's use of a credit term, and should be entitled either to security or to a satisfactory explanation.

The entire foregoing discussion as to adequacy of assurance by way of explanation is subject to qualification when repeated occasions for the application of this section arise. This Act recognizes that repeated delinquencies must be viewed as cumulative. On the other hand, commercial sense also requires that if repeated claims for assurance are made under this section, the basis for these claims must be increasingly obvious.

5. A failure to provide adequate assurance of performance and thereby to re-establish the security of expectation, results in a breach only "by repudiation" under subsection (4). Therefore, the possibility is continued of retraction of the repudiation under the section dealing with that problem, unless the aggrieved party has acted on the breach in some manner.

The thirty-day limit on the time to provide assurance is laid down to free the question of reasonable time from uncertainty in later litigation.

6. Clauses seeking to give the protected party exceedingly wide powers to cancel or readjust the contract when ground for insecurity arises must be read against the fact that good faith is a part of the obligation of the contract and not subject to modification by agreement and includes, in the case of a merchant, the reasonable observance of commercial standards of fair dealing in the trade. Such clauses can thus be effective to enlarge the protection given by the present section to a certain extent, to fix the reasonable time within which requested assurance must be given, or to define adequacy of the assurance in any commercially reasonable fashion. But any clause seeking to set up arbitrary standards for action is ineffective under this Article [Chapter]. Acceleration clauses are treated similarly in the Articles [Chapters] on Commercial Paper and Secured Transactions.

Cross References: Point 3: Section 1-203.

Point 5: Section 2-611.

Point 6: Sections 1-203 and 1-208 and Articles [Chapters] 3 and 9.

Definitional Cross References: "Aggrieved party." Section 1-201.

"Between merchants." Section 2-104.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Party." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Rights." Section 1-201.

"Writing." Section 1-201.

§ 28-2-610. Anticipatory repudiation. — When either party repudiates the contract with respect to a performance not yet due the loss of which will substantially impair the value of the contract to the other, the aggrieved party may

(a) for a commercially reasonable time await performance by the repudiating party; or (b) resort to any remedy for breach (section 28-2-703[, Idaho Code] or section 28-2-711[, Idaho Code]), even though he has notified the repudiating party that he would await the latter's performance and has urged retraction; and (c) in either case suspend his own performance or proceed in accordance with the provisions of this chapter on the seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods (section 28-2-704[, Idaho Code]).

History.

1967, ch. 161, § 2-610, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (b) and (c) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Application.

Where plaintiff's representatives testified that they would not make payments to defendant unless defendant agreed to trade checks for money it owed to a third party, and plaintiff did not pay because of defendant's

refusal to submit to conditions outside the contract, it amounted to a repudiation by plaintiff. Magic Valley Foods, Inc. v. Sun Valley Potatoes, Inc., 134 Idaho 785, 10 P.3d 734 (2000).

Rescission or Waiver.

Where a buyer accepted a refund of the deposit he had given the seller, the buyer simply received so much of the price as he had paid and he was still entitled to his additional remedies upon the seller's breach of their purchase agreement; the buyer's acceptance of the refund did not amount to a rescission or a waiver of his rights. Palmer v. Idaho Peterbilt, Inc., 102 Idaho 800, 641 P.2d 346 (Ct. App. 1982).

Time of Repudiation.

Where the seller of a truck sent a letter to the buyer enclosing a refund of the buyer's cash deposit and stating in a clear and unequivocal manner that no performance would be forthcoming from the seller, the buyer no longer had a reasonable expectation of performance by the seller, and the time of the repudiation of the contract by the seller was the time of the breach to be used in determining the market price of the truck for the purposes of measuring damages. Palmer v. Idaho Peterbilt, Inc., 102 Idaho 800, 641 P.2d 346 (Ct. App. 1982).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 801 et seq.

Official Comment

Prior Uniform Statutory Provision: See Sections 63(2) and 65, Uniform Sales Act.

Purposes: To make it clear that: 1. With the problem of insecurity taken care of by the preceding section and with provision being made in this Article [Chapter] as to the effect of a defective delivery under an installment contract, anticipatory repudiation centers upon an overt communication of intention or an action which renders performance impossible or demonstrates a clear determination not to continue with performance.

Under the present section when such a repudiation substantially impairs the value of the contract, the aggrieved party may at any time resort to his remedies for breach, or he may suspend his own performance while he negotiates with, or awaits performance by, the other party. But if he awaits performance beyond a commercially reasonable time he cannot recover resulting damages which he should have avoided.

2. It is not necessary for repudiation that performance be made literally and utterly impossible. Repudiation can result from action which reasonably indicates a rejection of the continuing obligation. And, a repudiation automatically results under the preceding section on insecurity when a party fails to provide adequate assurance of due future performance within thirty days after a justifiable demand therefor has been made. Under the language of this section, a demand by one or both parties for more than the contract calls for in the way of counter-performance is not in itself a repudiation nor does it invalidate a plain expression of desire for future performance. However, when under a fair reading it amounts to a statement of intention not to perform except on conditions which go beyond the contract, it becomes a repudiation.

3. The test chosen to justify an aggrieved party's action under this section is the same as that in the section on breach in installment contracts — namely the substantial value of the contract. The most useful test of substantial value is to determine whether material inconvenience or injustice will result if the aggrieved party is forced to wait and receive an ultimate tender minus the part or aspect repudiated.

4. After repudiation, the aggrieved party may immediately resort to any remedy he chooses provided he moves in good faith (see Section 1-203). Inaction and silence by the aggrieved party may leave the matter open but it cannot be regarded as misleading the repudiating party. Therefore the aggrieved party is left free to proceed at any time with his options under this section, unless he has taken some positive action which in good faith requires notification to the other party before the remedy is pursued.

Cross References: Point 1: Sections 2-609 and 2-612.

Point 2: Section 2-609.

Point 3: Section 2-612.

Point 4: Section 1-203.

Definitional Cross References: "Aggrieved party." Section 1-201.

"Contract." Section 1-201.

"Party." Section 1-201.

"Remedy." Section 1-201.

§ 28-2-611. Retraction of anticipatory repudiation. — (1) Until the repudiating party's next performance is due he can retract his repudiation unless the aggrieved party has since the repudiation cancelled or materially changed his position or otherwise indicated that he considers the repudiation final.

(2) Retraction may be by any method which clearly indicates to the aggrieved party that the repudiating party intends to perform, but must include any assurance justifiably demanded under the provisions of this chapter (section 28-2-609[, Idaho Code]).

(3) Retraction reinstates the repudiating party's rights under the contract with due excuse and allowance to the aggrieved party for any delay occasioned by the repudiation.

History.

1967, ch. 161, § 2-611, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion at the end of subsection (2) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 801 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: To make it clear that: 1. The repudiating party's right to reinstate the contract is entirely dependent upon the action taken by the aggrieved party. If the latter has cancelled the contract or materially

changed his position at any time after the repudiation, there can be no retraction under this section.

2. Under subsection (2) an effective retraction must be accompanied by any assurances demanded under the section dealing with right to adequate assurance. A repudiation is of course sufficient to give reasonable ground for insecurity and to warrant a request for assurance as an essential condition of the retraction. However, after a timely and unambiguous expression of retraction, a reasonable time for the assurance to be worked out should be allowed by the aggrieved party before cancellation.

Cross Reference: Point 2: Section 2-609.

Definitional Cross References: "Aggrieved party." Section 1-201.

"Cancellation." Section 2-106.

"Contract." Section 1-201.

"Party." Section 1-201.

"Rights." Section 1-201.

§ 28-2-612. "Installment contract" — Breach. — (1) An "installment contract" is one which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause "each delivery is a separate contract" or its equivalent.

(2) The buyer may reject any installment which is nonconforming if the nonconformity substantially impairs the value of that installment and cannot be cured or if the nonconformity is a defect in the required documents; but if the nonconformity does not fall within subsection (3) and the seller gives adequate assurance of its cure the buyer must accept that installment.

(3) Whenever nonconformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole. But the aggrieved party reinstates the contract if he accepts a nonconforming installment without seasonably notifying of cancellation or if he brings an action with respect only to past installments or demands performance as to future installments.

History.

1967, ch. 161, § 2-612, p. 351.

CASE NOTES

Buyer's Breach.

Where defendant company timely notified plaintiff company of its intent to cancel by informing plaintiff's representative that it would not make any more deliveries absent payment, the district court correctly concluded that defendant was justified in withholding deliveries under the contract because of plaintiff's lack of significant payment. Magic Valley Foods, Inc. v. Sun Valley Potatoes, Inc., 134 Idaho 785, 10 P.3d 734 (2000).

Reinstatement of Contract.

District court properly entered a judgment in favor of a company in the grower's contract dispute arising from the development of bacterial ring rot in two of the potato varieties grown by the company for the grower because, inter alia, statutory recertification was not required by the contract, the grower's actions — selling some of the uninfected potatoes and making a payment to the company — were inconsistent with the company's ownership of the seed, as the grower's acceptance of the uninfected potatoes reinstated the contract Silver Creek Seed, LLC v. Sunrain Varieties, LLC, 161 Idaho 270, 385 P.3d 448 (2016).

Official Comment

Prior Uniform Statutory Provision: Section 45(2), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To continue prior law but to make explicit the more mercantile interpretation of many of the rules involved, so that: 1. The definition of an installment contract is phrased more broadly in this Article [Chapter] so as to cover installment deliveries tacitly authorized by the circumstances or by the option of either party.

2. In regard to the apportionment of the price for separate payment this Article [Chapter] applies the more liberal test of what can be apportioned rather than the test of what is clearly apportioned by the agreement. This Article [Chapter] also recognizes approximate calculation or apportionment of price subject to subsequent adjustment. A provision for separate payment for each lot delivered ordinarily means that the price is at least roughly calculable by units of quantity, but such a provision is not essential to an "installment contract." If separate acceptance of separate deliveries is contemplated, no generalized contrast between wholly "entire" and wholly "divisible" contracts has any standing under this Article [Chapter].

3. This Article [Chapter] rejects any approach which gives clauses such as "each delivery is a separate contract" their legalistically literal effect. Such contracts nonetheless call for installment deliveries. Even where a clause speaks of "a separate contract for all purposes," a commercial reading of the language under the section on good faith and commercial standards requires that the singleness of the document and the negotiation,

together with the sense of the situation, prevail over any uncommercial and legalistic interpretation.

4. One of the requirements for rejection under subsection (2) is nonconformity substantially impairing the value of the installment in question. However, an installment agreement may require accurate conformity in quality as a condition to the right to acceptance if the need for such conformity is made clear either by express provision or by the circumstances. In such a case the effect of the agreement is to define explicitly what amounts to substantial impairment of value impossible to cure. A clause requiring accurate compliance as a condition to the right to acceptance must, however, have some basis in reason, must avoid imposing hardship by surprise and is subject to waiver or to displacement by practical construction.

Substantial impairment of the value of an installment can turn not only on the quality of the goods but also on such factors as time, quantity, assortment, and the like. It must be judged in terms of the normal or specifically known purposes of the contract. The defect in required documents refers to such matters as the absence of insurance documents under a C.I.F. contract, falsity of a bill of lading, or one failing to show shipment within the contract period or to the contract destination. Even in such cases, however, the provisions on cure of tender apply if appropriate documents are readily procurable.

5. Under subsection (2) an installment delivery must be accepted if the nonconformity is curable and the seller gives adequate assurance of cure. Cure of nonconformity of an installment in the first instance can usually be afforded by an allowance against the price, or in the case of reasonable discrepancies in quantity either by a further delivery or a partial rejection. This Article [Chapter] requires reasonable action by a buyer in regard to discrepant delivery and good faith requires that the buyer make any reasonable minor outlay of time or money necessary to cure an overshipment by severing out an acceptable percentage thereof. The seller must take over a cure which involves any material burden; the buyer's obligation reaches only to cooperation. Adequate assurance for purposes of subsection (2) is measured by the same standards as under the section on right to adequate assurance of performance.

6. Subsection (3) is designed to further the continuance of the contract in the absence of an overt cancellation. The question arising when an action is brought as to a single installment only is resolved by making such action waive the right of cancellation. This involves merely a defect in one or more installments, as contrasted with the situation where there is a true repudiation within the section on anticipatory repudiation. Whether the nonconformity in any given installment justifies cancellation as to the future depends, not on whether such nonconformity indicates an intent or likelihood that the future deliveries will also be defective, but whether the nonconformity substantially impairs the value of the whole contract. If only the seller's security in regard to future installments is impaired, he has the right to demand adequate assurances of proper future performance but has not an immediate right to cancel the entire contract. It is clear under this Article [Chapter], however, that defects in prior installments are cumulative in effect, so that acceptance does not wash out the defect "waived." Prior policy is continued, putting the rule as to buyer's default on the same footing as that in regard to seller's default.

7. Under the requirement of seasonable notification of cancellation under subsection (3), a buyer who accepts a nonconforming installment which substantially impairs the value of the entire contract should properly be permitted to withhold his decision as to whether or not to cancel pending a response from the seller as to his claim for cure or adjustment. Similarly, a seller may withhold a delivery pending payment for prior ones, at the same time delaying his decision as to cancellation. A reasonable time for notifying of cancellation, judged by commercial standards under the section on good faith, extends of course to include the time covered by any reasonable negotiation in good faith. However, during this period the defaulting party is entitled, on request, to know whether the contract is still in effect, before he can be required to perform further.

Cross References: Point 2: Sections 2-307 and 2-607.

Point 3: Section 1-203.

Point 5: Sections 2-208 and 2-609.

Point 6: Section 2-610.

Definitional Cross References: "Action." Section 1-201.

"Aggrieved party." Section 1-201.

"Buyer." Section 2-103.

"Cancellation." Section 2-106.

"Conform." Section 2-106.

"Contract." Section 1-201.

"Lot." Section 2-105.

"Notifies." Section 1-201.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

§ 28-2-613. Casualty to identified goods. — Where the contract requires for its performance goods identified when the contract is made, and the goods suffer casualty without fault of either party before the risk of loss passes to the buyer, or in a proper case under a "no arrival, no sale" term (section 28-2-324[, Idaho Code]) then

(a) if the loss is total the contract is avoided; and (b) if the loss is partial or the goods have so deteriorated as no longer to conform to the contract the buyer may nevertheless demand inspection and at his option either treat the contract as avoided or accept the goods with due allowance from the contract price for the deterioration or the deficiency in quantity but without further right against the seller.

History.

1967, ch. 161, § 2-613, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in the introductory paragraph was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Application.

This section applies only when the goods are damaged through no fault of either party before the risk of loss passes to the buyer. Beal v. Griffin, 123 Idaho 445, 849 P.2d 118 (Ct. App. 1993).

Fault.

Fault includes negligence and not merely willful wrong. Beal v. Griffin, 123 Idaho 445, 849 P.2d 118 (Ct. App. 1993).

Nonconforming Goods.

Where the goods are nonconforming, it is the buyer's choice to treat the contract as voided or accept the goods with allowance from the contract price; the seller cannot force the buyer to make the election. Beal v. Griffin, 123 Idaho 445, 849 P.2d 118 (Ct. App. 1993).

Official Comment

Prior Uniform Statutory Provision: Sections 7 and 8, Uniform Sales Act.

Changes: Rewritten, the basic policy being continued but the test of a "divisible" or "indivisible" sale or contract being abandoned in favor of adjustment in business terms.

Purposes of Changes: 1. Where goods whose continued existence is presupposed by the agreement are destroyed without fault of either party, the buyer is relieved from his obligation but may at his option take the surviving goods at a fair adjustment. "Fault" is intended to include negligence and not merely wilful wrong. The buyer is expressly given the right to inspect the goods in order to determine whether he wishes to avoid the contract entirely or to take the goods with a price adjustment.

2. The section applies whether the goods were already destroyed at the time of contracting without the knowledge of either party or whether they are destroyed subsequently but before the risk of loss passes to the buyer. Where under the agreement, including of course usage of trade, the risk has passed to the buyer before the casualty, the section has no application. Beyond this, the essential question in determining whether the rules of this section are to be applied is whether the seller has or has not undertaken the responsibility for the continued existence of the goods in proper condition through the time of agreed or expected delivery.

3. The section on the term "no arrival, no sale" makes clear that delay in arrival, quite as much as physical change in the goods, gives the buyer the options set forth in this section.

Cross Reference: Point 3: Section 2-324.

Definitional Cross References: "Buyer." Section 2-103.

"Conform." Section 2-106.

"Contract." Section 1-201.

"Fault." Section 1-201.

"Goods." Section 2-105.

"Party." Section 1-201.

"Rights." Section 1-201.

"Seller." Section 2-103.

§ 28-2-614. Substituted performance. — (1) Where without fault of either party the agreed berthing, loading, or unloading facilities fail or an agreed type of carrier becomes unavailable or the agreed manner of delivery otherwise becomes commercially impracticable but a commercially reasonable substitute is available, such substitute performance must be tendered and accepted.

(2) If the agreed means or manner of payment fails because of domestic or foreign governmental regulation, the seller may withhold or stop delivery unless the buyer provides a means or manner of payment which is commercially a substantial equivalent. If delivery has already been taken, payment by the means or in the manner provided by the regulation discharges the buyer's obligation unless the regulation is discriminatory, oppressive or predatory.

History.

1967, ch. 161, § 2-614, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 473 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. Subsection (1) requires the tender of a commercially reasonable substituted performance where agreed to facilities have failed or become commercially impracticable. Under this Article [Chapter], in the absence of specific agreement, the normal or usual facilities enter into the agreement either through the circumstances, usage of trade or prior course of dealing.

This section appears between Section 2-613 on casualty to identified goods and the next section on excuse by failure of presupposed conditions, both of which deal with excuse and complete avoidance of the contract where the occurrence or non-occurrence of a contingency which was a basic

assumption of the contract makes the expected performance impossible. The distinction between the present section and those sections lies in whether the failure or impossibility of performance arises in connection with an incidental matter or goes to the very heart of the agreement. The differing lines of solution are contrasted in a comparison of *International Paper Co. v. Rockefeller*, 161 App. Div. 180, 146 N.Y.S. 371 (1914) and *Meyer v. Sullivan*, 40 Cal. App. 723, 181 P. 847 (1919). In the former case a contract for the sale of spruce to be cut from a particular tract of land was involved. When a fire destroyed the trees growing on that tract the seller was held excused since performance was impossible. In the latter case the contract called for delivery of wheat "f.o.b. Kosmos Steamer at Seattle." The war led to cancellation of that line's sailing schedule after space had been duly engaged and the buyer was held entitled to demand substituted delivery at the warehouse on the line's loading dock. Under this Article [Chapter], of course, the seller would also be entitled, had the market gone the other way, to make a substituted tender in that manner.

There must, however, be a true commercial impracticability to excuse the agreed to performance and justify a substituted performance. When this is the case a reasonable substituted performance tendered by either party should excuse him from strict compliance with contract terms which do not go to the essence of the agreement.

2. The substitution provided in this section as between buyer and seller does not carry over into the obligation of a financing agency under a letter of credit, since such an agency is entitled to performance which is plainly adequate on its face and without need to look into commercial evidence outside of the documents. See Article [Chapter] 5, especially Sections 5-102, 5-103, 5-109, 5-110, 5-114.

3. Under subsection (2) where the contract is still executory on both sides, the seller is permitted to withdraw unless the buyer can provide him with a commercially equivalent return despite the governmental regulation. Where, however, only the debt for the price remains, a larger leeway is permitted. The buyer may pay in the manner provided by the regulation even though this may not be commercially equivalent provided that the regulation is not "discriminatory, oppressive or predatory."

Cross Reference: Point 2: Article [Chapter] 5.

Definitional Cross References: "Buyer." Section 2-103.

"Fault." Section 1-201.

"Party." Section 1-201.

"Seller." Section 2-103.

§ 28-2-615. Excuse by failure of presupposed conditions. — Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

(a) Delay in delivery or nondelivery in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

(b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.

(c) The seller must notify the buyer seasonably that there will be delay or nondelivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

History.

1967, ch. 161, § 2-615, p. 351.

CASE NOTES

Application.

The provisions of this section are applicable to buyers as long as there is compliance with the statutory requirements; thus, to prevail under this section, a buyer must prove that his performance was made impracticable by: (1) The occurrence of a contingency; (2) the nonoccurrence of which

was a basic assumption on which the contract was made; and (3) by which occurrence further performance has become commercially impracticable. Lawrance v. Elmore Bean Whse., Inc., 108 Idaho 892, 702 P.2d 930 (Ct. App. 1985).

Insufficient Excuses.

Mere market shifts or financial inability usually do not discharge one's performance. Lawrance v. Elmore Bean Whse., Inc., 108 Idaho 892, 702 P.2d 930 (Ct. App. 1985).

Cited Harvey v. Fearless Farris Whsle., Inc., 589 F.2d 451 (9th Cir. 1979).

RESEARCH REFERENCES

ALR. — Labor disputes as excusing, under UCC § 2-615, failure to deliver goods sold. 70 A.L.R.3d 1266.

Impracticability of performance of sales contract as defense under UCC § 2-615. 93 A.L.R.3d 584.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. This section excuses a seller from timely delivery of goods contracted for, where his performance has become commercially impracticable because of unforeseen supervening circumstances not within the contemplation of the parties at the time of contracting. The destruction of specific goods and the problem of the use of substituted performance on points other than delay or quantity, treated elsewhere in this Article [Chapter], must be distinguished from the matter covered by this section.

2. The present section deliberately refrains from any effort at an exhaustive expression of contingencies and is to be interpreted in all cases sought to be brought within its scope in terms of its underlying reason and purpose.

3. The first test for excuse under this Article [Chapter] in terms of basic assumption is a familiar one. The additional test of commercial impracticability (as contrasted with "impossibility," "frustration of

performance" or "frustration of the venture") has been adopted in order to call attention to the commercial character of the criterion chosen by this Article [Chapter].

4. Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover. But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section. (See *Ford & Sons, Ltd. v. Henry Leetham & Sons, Ltd.*, 21 Com. Cas. 55 (1915, K.B.D.).) 5. Where a particular source of supply is exclusive under the agreement and fails through casualty, the present section applies rather than the provision on destruction or deterioration of specific goods. The same holds true where a particular source of supply is shown by the circumstances to have been contemplated or assumed by the parties at the time of contracting. (See *Davis Co. v. Hoffmann-LaRoche Chemical Works*, 178 App. Div. 855, 166 N.Y.S. 179 (1917) and *International Paper Co. v. Rockefeller*, 161 App. Div. 180, 146 N.Y.S. 371 (1914).) There is no excuse under this section, however, unless the seller has employed all due measures to assure himself that his source will not fail. (See *Canadian Industrial Alcohol Co., Ltd., v. Dunbar Molasses Co.*, 258 N.Y. 194, 179 N.E. 383, 80 A.L.R. 1173 (1932) and *Washington Mfg. Co. v. Midland Lumber Co.*, 113 Wash. 593, 194 P. 777 (1921).) In the case of failure of production by an agreed source for causes beyond the seller's control, the seller should, if possible, be excused since production by an agreed source is without more a basic assumption of the contract. Such excuse should not result in relieving the defaulting supplier from liability nor in dropping into the seller's lap an unearned bonus of damages over. The flexible adjustment machinery of this Article [Chapter] provides the solution under the provision on the obligation of good faith. A condition to his making good the claim of excuse is the turning over to the buyer of his rights against the defaulting source of supply to the extent of the buyer's contract in relation to which excuse is being claimed.

6. In situations in which neither sense nor justice is served by either answer when the issue is posed in flat terms of “excuse” or “no excuse,” adjustment under the various provisions of this Article [Chapter] is necessary, especially the sections on good faith, on insecurity and assurance and on the reading of all provisions in the light of their purposes, and the general policy of this Act to use equitable principles in furtherance of commercial standards and good faith.

7. The failure of conditions which go to convenience or collateral values rather than to the commercial practicability of the main performance does not amount to a complete excuse. However, good faith and the reason of the present section and of the preceding one may properly be held to justify and even to require any needed delay involved in a good faith inquiry seeking a readjustment of the contract terms to meet the new conditions.

8. The provisions of this section are made subject to assumption of greater liability by agreement and such agreement is to be found not only in the expressed terms of the contract but in the circumstances surrounding the contracting, in trade usage and the like. Thus the exemptions of this section do not apply when the contingency in question is sufficiently foreshadowed at the time of contracting to be included among the business risks which are fairly to be regarded as part of the dickered terms, either consciously or as a matter of reasonable, commercial interpretation from the circumstances. (See *Madeirense Do Brasil, S.A. v. Stulman-Emrick Lumber Co*., 147 F.2d 399 (C.C.A., 2 Cir., 1945).) The exemption otherwise present through usage of trade under the present section may also be expressly negated by the language of the agreement. Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of this section are to be read in the light of mercantile sense and reason, for this section itself sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

Agreement can also be made in regard to the consequences of exemption as laid down in paragraphs (b) and (c) and the next section on procedure on notice claiming excuse.

9. The case of a farmer who has contracted to sell crops to be grown on designated land may be regarded as falling either within the section on casualty to identified goods or this section, and he may be excused, when

there is a failure of the specific crop, either on the basis of the destruction of identified goods or because of the failure of a basic assumption of the contract.

Exemption of the buyer in the case of a "requirements" contract is covered by the "Output and Requirements" section both as to assumption and allocation of the relevant risks. But when a contract by a manufacturer to buy fuel or raw material makes no specific reference to a particular venture and no such reference may be drawn from the circumstances, commercial understanding views it as a general deal in the general market and not conditioned on any assumption of the continuing operation of the buyer's plant. Even when notice is given by the buyer that the supplies are needed to fill a specific contract of a normal commercial kind, commercial understanding does not see such a supply contract as conditioned on the continuance of the buyer's further contract for outlet. On the other hand, where the buyer's contract is in reasonable commercial understanding conditioned on a definite and specific venture or assumption as, for instance, a war procurement subcontract known to be based on a prime contract which is subject to termination, or a supply contract for a particular construction venture, the reason of the present section may well apply and entitle the buyer to the exemption.

10. Following its basic policy of using commercial practicability as a test for excuse, this section recognizes as of equal significance either a foreign or domestic regulation and disregards any technical distinctions between "law," "regulation," "order" and the like. Nor does it make the present action of the seller depend upon the eventual judicial determination of the legality of the particular governmental action. The seller's good faith belief in the validity of the regulation is the test under this Article [Chapter] and the best evidence of his good faith is the general commercial acceptance of the regulation. However, governmental interference cannot excuse unless it truly "supervenes" in such a manner as to be beyond the seller's assumption of risk. And any action by the party claiming excuse which causes or colludes in inducing the governmental action preventing his performance would be in breach of good faith and would destroy his exemption.

11. An excused seller must fulfill his contract to the extent which the supervening contingency permits, and if the situation is such that his customers are generally affected he must take account of all in supplying

one. Subsections (a) and (b), therefore, explicitly permit in any proration a fair and reasonable attention to the needs of regular customers who are probably relying on spot orders for supplies. Customers at different stages of the manufacturing process may be fairly treated by including the seller's manufacturing requirements. A fortiori, the seller may also take account of contracts later in date than the one in question. The fact that such spot orders may be closed at an advanced price causes no difficulty, since any allocation which exceeds normal past requirements will not be reasonable. However, good faith requires, when prices have advanced, that the seller exercise real care in making his allocations, and in case of doubt his contract customers should be favored and supplies prorated evenly among them regardless of price. Save for the extra care thus required by changes in the market, this section seeks to leave every reasonable business leeway to the seller.

Cross References: Point 1: Sections 2-613 and 2-614.

Point 2: Section 1-102.

Point 5: Sections 1-203 and 2-613.

Point 6: Sections 1-102, 1-203 and 2-609.

Point 7: Section 2-614.

Point 8: Sections 1-201, 2-302 and 2-616.

Point 9: Sections 1-102, 2-306 and 2-613.

Definitional Cross References: "Between merchants." Section 2-104.

"Buyer." Section 2-103.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Good faith." Section 1-201.

"Merchant." Section 2-104.

"Notifies." Section 1-201.

"Seasonably." Section 1-204 [1-205].

"Seller." Section 2-103.

§ 28-2-616. Procedure on notice claiming excuse. — (1) Where the buyer receives notification of a material or indefinite delay or an allocation justified under the preceding section he may by written notification to the seller as to any delivery concerned, and where the prospective deficiency substantially impairs the value of the whole contract under the provisions of this chapter relating to breach of installment contracts (section 28-2-612[, Idaho Code]), then also as to the whole,

(a) terminate and thereby discharge any unexecuted portion of the contract; or (b) modify the contract by agreeing to take his available quota in substitution.

(2) If after receipt of such notification from the seller the buyer fails so to modify the contract within a reasonable time not exceeding thirty (30) days the contract lapses with respect to any deliveries affected.

(3) The provisions of this section may not be negated by agreement except insofar as the seller has assumed a greater obligation under the preceding section.

History.

1967, ch. 161, § 2-616, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion near the end of the introductory paragraph was added by the compiler to conform to the statutory citation style.

The words in parentheses so appeared in the law as enacted.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: This section seeks to establish simple and workable machinery for providing certainty as to when a supervening and excusing contingency "excuses" the delay, "discharges" the contract, or may result in

a waiver of the delay by the buyer. When the seller notifies, in accordance with the preceding section, claiming excuse, the buyer may acquiesce, in which case the contract is so modified. No consideration is necessary in a case of this kind to support such a modification. If the buyer does not elect so to modify the contract, he may terminate it and under subsection (2) his silence after receiving the seller's claim of excuse operates as such a termination. Subsection (3) denies effect to any contract clause made in advance of trouble which would require the buyer to stand ready to take delivery whenever the seller is excused from delivery by unforeseen circumstances.

Cross References: Point 1: Sections 2-209 and 2-615.

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Installment contract." Section 2-612.

"Notification." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Seller." Section 2-103.

"Termination." Section 2-106.

"Written." Section 1-201.

Part 7
Remedies

§ 28-2-701. Remedies for breach of collateral contracts not impaired. — Remedies for breach of any obligation or promise collateral or ancillary to a contract for sale are not impaired by the provisions of this chapter.

History.

1967, ch. 161, § 2-701, p. 351.

CASE NOTES

Cited Industrial Leasing Corp. v. Thomason, 96 Idaho 574, 532 P.2d 916 (1974); Olsen v. Country Club Sports, Inc., 110 Idaho 789, 718 P.2d 1227 (Ct. App. 1986).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 795 et seq.

C.J.S. — 77A C.J.S., Sales, § 536 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: Whether a claim for breach of an obligation collateral to the contract for sale requires separate trial to avoid confusion of issues is beyond the scope of this Article [Chapter]; but contractual arrangements which as a business matter enter vitally into the contract should be considered a part thereof in so far as cross-claims or defenses are concerned.

Definitional Cross References: "Contract for sale." Section 2-106.

"Remedy." Section 1-201.

§ 28-2-702. Seller's remedies on discovery of buyer's insolvency. — (1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods theretofore delivered under the contract, and stop delivery under this chapter (section 28-2-705[, Idaho Code]).

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten (10) days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three (3) months before delivery the ten (10) day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this chapter (section 28-2-403[, Idaho Code]). Successful reclamation of goods excludes all other remedies with respect to them.

History.

1967, ch. 161, § 2-702, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (1) and (3) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Bankruptcy.

Section 546(c) of Title 11 of the United States Code is the sole means for a seller to successfully assert a right to reclaim goods sold to an insolvent buyer when that buyer has filed for relief under the bankruptcy code. Additionally, a written demand for reclamation under the section is mandatory. Roberts v. L.T.S., Inc., 32 Bankr. 907 (Bankr. D. Idaho 1983).

Under the clear language of a provision of the bankruptcy code (11 U.S.C. § 546(c)) and the weight of authority, compliance with the requirement of a timely written demand is essential for a seller to claim property of the bankruptcy estate through the vehicle of statutory reclamation. Roberts v. L.T.S., Inc., 32 Bankr. 907 (Bankr. D. Idaho 1983).

Demand upon Dishonor.

Where debtor's sight draft was dishonored three days after debtor took possession of automobile and seller made demand for return within ten days after transfer of possession and dishonor, as required by this section, seller was entitled to return of automobile even though debtor retained possession for almost three months before he filed bankruptcy, since a sight draft is equivalent to a check and the sale is a cash sale instead of a credit sale so that the provisions of § 28-2-511 applied. Swayne v. Idaho Auto Auction (In re Shoemaker), 4 Bankr. 505 (Bankr. D. Idaho 1980).

Good Faith Purchaser.

Although a seller of goods may have certain rights to recover goods from an insolvent buyer and may treat a sale as void if retention of the goods is fraudulent, nevertheless those rights are altered when the goods enter the hands of a good faith purchaser for value. Western Idaho Prod. Credit Ass'n v. Simplot Feed Lots, Inc., 106 Idaho 260, 678 P.2d 52 (1984).

Cited Fletcher v. Anthony, 110 Idaho 317, 715 P.2d 987 (1986).

Decisions Under Prior Law

Defense of "unpaid seller."

Remedy after resale.

Stoppage in transitu.

Defense of "Unpaid Seller."

If purchase price remained unpaid, even if title to cattle passed with a bill of sale, the seller would prevail as an "unpaid seller" and would not be liable in damages for refusal to deliver. Bischoff v. Steele, 75 Idaho 485, 274 P.2d 986 (1954).

Remedy after Resale.

Where buyer under contract of sale of automobile gave his check in part payment and on same day stopped payment on the check, and seller put automobile back in stock and later sold it again in the regular course of business, seller could not treat the first sale as completed and recover purchase price from first buyer. Boise Overland Co. v. Fearn, 38 Idaho 590, 223 P. 534 (1924).

Stoppage in Transitu.

Where buyer did not take potatoes from bailee's cellar and refused to accept the potatoes and the potatoes remained in the cellar, the right of stoppage in transitu remained in the seller and, since the goods were of a perishable nature and, in fact, were spoiling prior to the date of resale by seller, the seller was within his rights in reselling the potatoes. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 894 et seq.

Official Comment

Prior Uniform Statutory Provision: Subsection (1) — Sections 53(1) (b), 54(1) (c) and 57, Uniform Sales Act; Subsection (2) — none; Subsection (3) — Section 76(3), Uniform Sales Act.

Changes: Rewritten, the protection given to a seller who has sold on credit and has delivered goods to the buyer immediately preceding his insolvency being extended.

Purposes of Changes and New Matter: To make it clear that: 1. The seller's right to withhold the goods or to stop delivery except for cash when he discovers the buyer's insolvency is made explicit in subsection (1) regardless of the passage of title, and the concept of stoppage has been

extended to include goods in the possession of any bailee who has not yet attorned to the buyer.

2. Subsection (2) takes as its base line the proposition that any receipt of goods on credit by an insolvent buyer amounts to a tacit business misrepresentation of solvency and therefore is fraudulent as against the particular seller. This Article [Chapter] makes discovery of the buyer's insolvency and demand within a ten day period a condition of the right to reclaim goods on this ground. The ten day limitation period operates from the time of receipt of the goods.

An exception to this time limitation is made when a written misrepresentation of solvency has been made to the particular seller within three months prior to the delivery. To fall within the exception the statement of solvency must be in writing, addressed to the particular seller and dated within three months of the delivery.

3. Subsection (3) subjects the right of reclamation to certain rights of third parties "under this Article [Chapter] (Section 2-403)." The rights so given priority of course include the rights given to purchasers from the buyer by Section 2-403(1) and (2). They also include other rights arising under Article [Chapter] 2, such as the rights of lien creditors of the buyer under Section 2-326(3) on consignment sales. Moreover, since Section 2-403(4) incorporates by reference rights given to other purchasers and to lien creditors by Articles [Chapters] 6, 7 and 9, such rights have the same priority. "Lien creditor" here has the same meaning as in Section 9-301(3). Thus if a seller retains an unperfected security interest, subordinate under Section 9-301(1) (b) to the rights of a levying creditor of the buyer, his right of reclamation under this section is also subject to the creditor's rights. Purchasers or lien creditors may also have rights not arising under this Article [Chapter]; under Section 1-103 such rights may have priority by virtue of supplementary principles not displaced by this Section. See *In re Kravitz*, 278 F.2d 820 (3d Cir. 1960).

Because the right of the seller to reclaim goods under this section constitutes preferential treatment as against the buyer's other creditors, subsection (3) provides that such reclamation bars all his other remedies as to the goods involved.

Cross References: Point 1: Sections 2-401 and 2-705.

Compare Section 2-502.

Definitional Cross References: “Buyer.” Section 2-103.

“Buyer in ordinary course of business.” Section 1-201.

“Contract.” Section 1-201.

“Good faith.” Section 1-201.

“Goods.” Section 2-105.

“Insolvent.” Section 1-201.

“Person.” Section 1-201.

“Purchaser.” Section 1-201.

“Receipt” of goods. Section 2-103.

“Remedy.” Section 1-201.

“Rights.” Section 1-201.

“Seller.” Section 2-103.

“Writing.” Section 1-201.

§ 28-2-703. Seller's remedies in general. — Where the buyer wrongfully rejects or revokes acceptance of goods or fails to make a payment due on or before delivery or repudiates with respect to a part or the whole, then with respect to any goods directly affected and, if the breach is of the whole contract (section 28-2-612[, Idaho Code]), then also with respect to the whole undelivered balance, the aggrieved seller may

(a) withhold delivery of such goods; (b) stop delivery by any bailee as hereafter provided (section 28-2-705[, Idaho Code]); (c) proceed under the next section respecting goods still unidentified to the contract; (d) resell and recover damages as hereafter provided (section 28-2-706[, Idaho Code]); (e) recover damages for nonacceptance (section 28-2-708[, Idaho Code]) or in a proper case the price (section 28-2-709[, Idaho Code]); (f) cancel.

History.

1967, ch. 161, § 2-703, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions throughout this section were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Cited Consolidated Supply Co. v. Babbitt, 96 Idaho 636, 534 P.2d 466 (1975); Fletcher v. Anthony, 110 Idaho 317, 715 P.2d 987 (1986).

Decisions Under Prior Law Liability.

If purchase price remained unpaid even, if title to cattle passed with bill of sale, the seller would prevail as an "unpaid seller" and would not be liable in damages for refusal to deliver. Bischoff v. Steele, 75 Idaho 485, 274 P.2d 986 (1954).

Official Comment

Prior Uniform Statutory Provision: No comparable index section. See Section 53, Uniform Sales Act.

Purposes: 1. This section is an index section which gathers together in one convenient place all of the various remedies open to a seller for any breach by the buyer. This Article [Chapter] rejects any doctrine of election of remedy as a fundamental policy and thus the remedies are essentially cumulative in nature and include all of the available remedies for breach. Whether the pursuit of one remedy bars another depends entirely on the facts of the individual case.

2. The buyer's breach which occasions the use of the remedies under this section may involve only one lot or delivery of goods, or may involve all of the goods which are the subject matter of the particular contract. The right of the seller to pursue a remedy as to all the goods when the breach is as to only one or more lots is covered by the section on breach in installment contracts. The present section deals only with the remedies available after the goods involved in the breach have been determined by that section.

3. In addition to the typical case of refusal to pay or default in payment, the language in the preamble, "fails to make a payment due," is intended to cover the dishonor of a check on due presentment, or the nonacceptance of a draft, and the failure to furnish an agreed letter of credit.

4. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1-106).

Cross References: Point 2: Section 2-612.

Point 3: Section 2-325.

Point 4: Section 1-106.

Definitional Cross References: "Aggrieved party." Section 1-201.

"Buyer." Section 2-103.

"Cancellation." Section 2-106.

“Contract.” Section 1-201.

“Goods.” Section 2-105.

“Remedy.” Section 1-201.

“Seller.” Section 2-103.

§ 28-2-704. Seller's right to identify goods to the contract notwithstanding breach or to salvage unfinished goods. — (1) An aggrieved seller under the preceding section may

(a) identify to the contract conforming goods not already identified if at the time he learned of the breach they are in his possession or control; (b) treat as the subject of resale goods which have demonstrably been intended for the particular contract even though those goods are unfinished.

(2) Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.

History.

1967, ch. 161, § 2-704, p. 351.

CASE NOTES

Decisions Under Prior Law Measure of damages.

Resale of property.

Measure of Damages.

Where a buyer refused to accept perishable property under a contract, it was the right of a seller to sell forthwith and in this manner reduce his damages. The measure of damages was the estimated loss directly and naturally resulting, in the ordinary course of events, from buyer's breach of contract. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

Resale of Property.

Upon delivery and refusal to accept delivery of potatoes, seller had the right to resell the property, regardless of the fact that title had not passed to the buyer, and to recover damages for any loss sustained because of breach

of the contract, such potatoes being sold at the market price at the time of resale, in this manner reducing his damages. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 894 et seq.

Official Comment

Prior Uniform Statutory Provision: Sections 63(3) and 64(4), Uniform Sales Act.

Changes: Rewritten, the seller's rights being broadened.

Purposes of Changes: 1. This section gives an aggrieved seller the right at the time of breach to identify to the contract any conforming finished goods, regardless of their resalability, and to use reasonable judgment as to completing unfinished goods. It thus makes the goods available for resale under the resale section, the seller's primary remedy, and in the special case in which resale is not practicable, allows the action for the price which would then be necessary to give the seller the value of his contract.

2. Under this Article [Chapter] the seller is given express power to complete manufacture or procurement of goods for the contract unless the exercise of reasonable commercial judgment as to the facts as they appear at the time he learns of the breach makes it clear that such action will result in a material increase in damages. The burden is on the buyer to show the commercially unreasonable nature of the seller's action in completing manufacture.

Cross References: Sections 2-703 and 2-706.

Definitional Cross References: "Aggrieved party." Section 1-201.

"Conforming." Section 2-106.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Rights." Section 1-201.

“Seller.” Section 2-103.

§ 28-2-705. Seller's stoppage of delivery in transit or otherwise. — (1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (section 28-2-702[, Idaho Code]) and may stop delivery of carload, truckload, plane load or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.

(2) As against such buyer the seller may stop delivery until (a) receipt of the goods by the buyer; or

(b) acknowledgment to the buyer by any bailee of the goods except a carrier that the bailee holds the goods for the buyer; or (c) such acknowledgment to the buyer by a carrier by reshipment or as a warehouse; or (d) negotiation to the buyer of any negotiable document of title covering the goods.

(3)(a) To stop delivery the seller must so notify as to enable the bailee by reasonable diligence to prevent delivery of the goods.

(b) After such notification the bailee must hold and deliver the goods according to the directions of the seller but the seller is liable to the bailee for any ensuing charges or damages.

(c) If a negotiable document of title has been issued for goods the bailee is not obliged to obey a notification to stop until surrender of possession or control of the document.

(d) A carrier who has issued a nonnegotiable bill of lading is not obliged to obey a notification to stop received from a person other than the consignor.

History.

1967, ch. 161, § 2-705, p. 351; am. 2004, ch. 42, § 14, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in subsection (1) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Contract executory until delivery.

Delivery defined.

Stoppage necessary before actual delivery.

Stoppage necessary before actual receipt.

Contract Executory Until Delivery.

Where the parties were involved in a shipment contract, wherein the seller's performance was completed upon tender of the goods to the carrier, and no stoppage in transit occurred, the completed status of the contract was never undone and, at the time the debtors filed their petition, no executory contract existed to be assumed by the debtor in possession; therefore, the debt was not entitled to priority administrative expense treatment. In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

Contracts where the shipment terms require the seller to deliver to the buyer's place of business remain executory until the goods are actually received by the buyer, regardless of whether the seller stops the goods in transit or allows them to continue on their way. In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

Delivery Defined.

Delivery, for purposes of this section, means receipt of the goods by the buyer; one can have delivery without receipt. In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

Stoppage Necessary Before Actual Delivery.

In the case of a shipment contract, where the seller's performance is completed upon tender of the goods at the seller's place of business, an actual stoppage in transit is required in order to undo performance and again make the contract executory. In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

The critical factor for stoppage of goods in transit is that the stoppage must occur prior to actual physical possession of the goods by the buyer; once the buyer has possession they are no longer in transit. In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

Stoppage Necessary Before Actual Receipt.

Stoppage in transit is a potential remedy for the seller in the instance where goods are in transit to an insolvent buyer, but the seller must act before the buyer actually receives the goods in order to take advantage of this remedy. In re Nevins Ammunition, Inc., 79 Bankr. 11 (Bankr. D. Idaho 1987).

Decisions Under Prior Law

Stoppage in Transitu.

Where buyer refused to take potatoes from bailee's cellar and refused to accept the potatoes, and the potatoes remained in the cellar, the right of stoppage in transitu remained in the seller and, since the goods were of a perishable nature and in fact were spoiling prior to the date of resale by the seller, the seller was within his rights in reselling the potatoes. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

Official Comment

Prior Uniform Statutory Provision: Sections 57-59, Uniform Sales Act; see also Sections 12, 14 and 42, Uniform Bills of Lading Act and Sections 9, 11 and 49, Uniform Warehouse Receipts Act.

Changes: This section continues and develops the above sections of the Uniform Sales Act in the light of the other uniform statutory provisions noted.

Purposes: To make it clear that:

1. Subsection (1) applies the stoppage principle to other bailees as well as carriers.

It also expands the remedy to cover the situations, in addition to buyer's insolvency, specified in the subsection. But since stoppage is a burden in any case to carriers, and might be a very heavy burden to them if it covered

all small shipments in all these situations, the right to stop for reasons other than insolvency is limited to carload, truckload, planeload or larger shipments. The seller shipping to a buyer of doubtful credit can protect himself by shipping C.O.D.

Where stoppage occurs for insecurity it is merely a suspension of performance, and if assurances are duly forthcoming from the buyer the seller is not entitled to resell or divert.

Improper stoppage is a breach by the seller if it effectively interferes with the buyer's right to due tender under the section on manner of tender of delivery. However, if the bailee obeys an unjustified order to stop he may also be liable to the buyer. The measure of his obligation is dependent on the provisions of the Documents of Title Article [Chapter] (Section 7-303). Subsection 3(b) therefore gives him a right of indemnity as against the seller in such a case.

2. "Receipt by the buyer" includes receipt by the buyer's designated representative, the subpurchaser, when shipment is made direct to him and the buyer himself never receives the goods. It is entirely proper under this Article [Chapter] that the seller, by making such direct shipment to the subpurchaser, be regarded as acquiescing in the latter's purchase and as thus barred from stoppage of the goods as against him.

As between the buyer and the seller, the latter's right to stop the goods at any time until they reach the place of final delivery is recognized by this section.

Under subsection (3)(c) and (d), the carrier is under no duty to recognize the stop order of a person who is a stranger to the carrier's contract. But the seller's right as against the buyer to stop delivery remains, whether or not the carrier is obligated to recognize the stop order. If the carrier does obey it, the buyer cannot complain merely because of that circumstance; and the seller becomes obligated under subsection (3)(b) to pay the carrier any ensuing damages or charges.

3. A diversion of a shipment is not a "reshipment" under subsection (2)(c) when it is merely an incident to the original contract of transportation. Nor is the procurement of "exchange bills" of lading which change only the

name of the consignee to that of the buyer's local agent but do not alter the destination of a reshipment.

Acknowledgment by the carrier as a "warehouse" within the meaning of this Article [Chapter] requires a contract of a truly different character from the original shipment, a contract not in extension of transit but as a warehouse.

4. Subsection (3)(c) makes the bailee's obedience of a notification to stop conditional upon the surrender of possession or control of any outstanding negotiable document.

5. Any charges or losses incurred by the carrier in following the seller's orders, whether or not he was obligated to do so, fall to the seller's charge.

6. After an effective stoppage under this section the seller's rights in the goods are the same as if he had never made a delivery.

Cross References: Sections 2-702 and 2-703.

Point 1: Sections 2-503 and 2-609, and Article [Chapter] 7.

Point 2: Section 2-103 and Article [Chapter] 7.

Definitional Cross References: "Buyer." Section 2-103.

"Contract for sale." Section 2-106.

"Document of title." Section 1-201.

"Goods." Section 2-105.

"Insolvent." Section 1-201.

"Notification." Section 1-201.

"Receipt" of goods. Section 2-103.

"Rights." Section 1-201.

"Seller." Section 2-103.

§ 28-2-706. Seller's resale including contract for resale. — (1) Under the conditions stated in section 28-2-703[, Idaho Code,] on seller's remedies, the seller may resell the goods concerned or the undelivered balance thereof. Where the resale is made in good faith and in a commercially reasonable manner the seller may recover the difference between the resale price and the contract price together with any incidental damages allowed under the provisions of this chapter (section 28-2-710[, Idaho Code]), but less expenses saved in consequence of the buyer's breach.

(2) Except as otherwise provided in subsection (3) or unless otherwise agreed resale may be at public or private sale including sale by way of one or more contracts to sell or of identification to an existing contract of the seller. Sale may be as a unit or in parcels and at any time and place and on any terms but every aspect of the sale including the method, manner, time, place and terms must be commercially reasonable. The resale must be reasonably identified as referring to the broken contract, but it is not necessary that the goods be in existence or that any or all of them have been identified to the contract before the breach.

(3) Where the resale is at private sale the seller must give the buyer reasonable notification of his intention to resell.

(4) Where the resale is at public sale

(a) only identified goods can be sold except where there is a recognized market for a public sale of futures in goods of the kind; and (b) it must be made at a usual place or market for public sale if one is reasonably available and except in the case of goods which are perishable or threaten to decline in value speedily the seller must give the buyer reasonable notice of the time and place of the resale; and (c) if the goods are not to be within the view of those attending the sale the notification of sale must state the place where the goods are located and provide for their reasonable inspection by prospective bidders; and (d) the seller may buy.

(5) A purchaser who buys in good faith at a resale takes the goods free of any rights of the original buyer even though the seller fails to comply with

one or more of the requirements of this section.

(6) The seller is not accountable to the buyer for any profit made on any resale. A person in the position of a seller (section 28-2-707[, Idaho Code]) or a buyer who has rightfully rejected or justifiably revoked acceptance must account for any excess over the amount of his security interest, as hereinafter defined (subsection (3) of section 28-2-711[, Idaho Code]).

History.

1967, ch. 161, § 2-706, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (1) and (6) were added by the compiler to conform to the statutory citation style.

The words in parentheses so appeared in the law as enacted.

CASE NOTES

Damages.

There was no error in magistrate's decision to offset the deposit for used engine against damages awarded to buyers for breach of implied warranty of merchantability and implied warranty of fitness for a particular purpose; buyer did not have to return the engine and seller was in no worse position than if buyers had resold the engine and deducted the resale price from their damages. Berning v. Drumwright, 122 Idaho 203, 832 P.2d 1138 (Ct. App. 1992).

Cited Industrial Leasing Corp. v. Thomason, 96 Idaho 574, 532 P.2d 916 (1974); Deutz-Allis Credit Corp. v. Bakie Logging, 121 Idaho 247, 824 P.2d 178 (Ct. App. 1992).

Decisions Under Prior Law

Resale of perishable goods.

Amount of Damages.

Where buyer refused to accept perishable property under a contract, it was the right of the seller to sell forthwith and in this manner reduce his damages. The measure of damages was the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer's breach of contract. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

Care by Seller.

It was recognized that the seller was bound to exercise reasonable care and judgment when he retook possession of property and sold it for the account of the buyer. C.I.T. Corps. v. Hess, 88 Idaho 1, 395 P.2d 471 (1964).

Remedy Against First Buyer.

Where buyer under contract of purchase of automobile gave his check in part payment and on same day stopped payment on check, seller put automobile back in stock and later sold it again, in the regular course of business, seller could not treat the first sale as completed and recover purchase price from the first buyer. Boise Overland Co. v. Fearn, 38 Idaho 590, 223 P. 534 (1924).

Upon delivery and refusal to accept delivery of potatoes, seller has a right to resell the property, regardless of the fact that title had not passed to buyer, and to recover damages for any loss sustained because of breach of contract, such potatoes being sold at the market price at the time of resale, in this manner reducing his damages. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

Resale of Perishable Goods.

Where buyer did not take potatoes from bailee's cellar and refused to accept the potatoes and the potatoes remained in the cellar, the right of stoppage in transitu remained in the seller and, since the goods were of a perishable nature and in fact were spoiling prior to the date of resale by the seller, the seller was within his rights in reselling the potatoes. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

RESEARCH REFERENCES

Am. Jur. 2d. — 68A Am. Jur. 2d, Secured Transactions, § 580 et seq.

ALR. — Resale of goods under UCC § 2-706. 101 A.L.R.5th 563.

Official Comment

Prior Uniform Statutory Provision: Section 60, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To simplify the prior statutory provision and to make it clear that: 1. The only condition precedent to the seller's right of resale under subsection (1) is a breach by the buyer within the section on the seller's remedies in general or insolvency. Other meticulous conditions and restrictions of the prior uniform statutory provision are disapproved by this Article [Chapter] and are replaced by standards of commercial reasonableness. Under this section the seller may resell the goods after any breach by the buyer. Thus, an anticipatory repudiation by the buyer gives rise to any of the seller's remedies for breach, and to the right of resale. This principle is supplemented by subsection (2) which authorizes a resale of goods which are not in existence or were not identified to the contract before the breach.

2. In order to recover the damages prescribed in subsection (1) the seller must act "in good faith and in a commercially reasonable manner" in making the resale. This standard is intended to be more comprehensive than that of "reasonable care and judgment" established by the prior uniform statutory provision. Failure to act properly under this section deprives the seller of the measure of damages here provided and relegates him to that provided in Section 2-708.

Under this Article [Chapter] the seller resells by authority of law, in his own behalf, for his own benefit and for the purpose of fixing his damages. The theory of a seller's agency is thus rejected.

3. If the seller complies with the prescribed standard of duty in making the resale, he may recover from the buyer the damages provided for in subsection (1). Evidence of market or current prices at any particular time

or place is relevant only on the question of whether the seller acted in a commercially reasonable manner in making the resale.

The distinction drawn by some courts between cases where the title had not passed to the buyer and the seller had resold as owner, and cases where the title had passed and the seller had resold by virtue of his lien on the goods, is rejected.

4. Subsection (2) frees the remedy of resale from legalistic restrictions and enables the seller to resell in accordance with reasonable commercial practices so as to realize as high a price as possible in the circumstances. By "public" sale is meant a sale by auction. A "private" sale may be effected by solicitation and negotiation conducted either directly or through a broker. In choosing between a public and private sale the character of the goods must be considered and relevant trade practices and usages must be observed.

5. Subsection (2) merely clarifies the common-law rule that the time for resale is a reasonable time after the buyer's breach, by using the language "commercially reasonable." What is such a reasonable time depends upon the nature of the goods, the condition of the market and the other circumstances of the case; its length cannot be measured by any legal yardstick or divided into degrees. Where a seller contemplating resale receives a demand from the buyer for inspection under the section of preserving evidence of goods in dispute, the time for resale may be appropriately lengthened.

On the question of the place for resale, subsection (2) goes to the ultimate test, the commercial reasonableness of the seller's choice as to the place for an advantageous resale. This Article [Chapter] rejects the theory that the seller is required to resell at the agreed place for delivery and that a resale elsewhere can be permitted only in exceptional cases.

6. The purpose of subsection (2) being to enable the seller to dispose of the goods to the best advantage, he is permitted in making the resale to depart from the terms and conditions of the original contract for sale to any extent "commercially reasonable" in the circumstances.

7. The provision of subsection (2) that the goods need not be in existence to be resold applies when the buyer is guilty of anticipatory repudiation of a

contract for future goods, before the goods or some of them have come into existence. In such a case the seller may exercise the right of resale and fix his damages by "one or more contracts to sell" the quantity of conforming future goods affected by the repudiation. The companion provision of subsection (2) that resale may be made although the goods were not identified to the contract prior to the buyer's breach, likewise contemplates an anticipatory repudiation by the buyer but occurring after the goods are in existence. If the goods so identified conform to the contract, their resale will fix the seller's damages quite as satisfactorily as if they had been identified before the breach.

8. Where the resale is to be by private sale, subsection (3) requires that reasonable notification of the seller's intention to resell must be given to the buyer. The length of notification of a private sale depends upon the urgency of the matter. Notification of the time and place of this type of sale is not required.

Subsection (4)(b) requires that the seller give the buyer reasonable notice of the time and place of a public resale so that he may have an opportunity to bid or to secure the attendance of other bidders. An exception is made in the case of goods "which are perishable or threaten to decline speedily in value."

9. Since there would be no reasonable prospect of competitive bidding elsewhere, subsection (4) requires that a public resale "must be made at a usual place or market for public sale if one is reasonably available;" i.e., a place or market which prospective bidders may reasonably be expected to attend. Such a market may still be "reasonably available" under this subsection, though at a considerable distance from the place where the goods are located. In such a case the expense of transporting the goods for resale is recoverable from the buyer as part of the seller's incidental damages under subsection (1). However, the question of availability is one of commercial reasonableness in the circumstances and if such "usual" place or market is not reasonably available, a duly advertised public resale may be held at another place if it is one which prospective bidders may reasonably be expected to attend, as distinguished from a place where there is no demand whatsoever for goods of the kind.

Paragraph (a) of subsection (4) qualifies the last sentence of subsection (2) with respect to resales of unidentified and future goods at public sale. If conforming goods are in existence the seller may identify them to the contract after the buyer's breach and then resell them at public sale. If the goods have not been identified, however, he may resell them at public sale only as "future" goods and only where there is a recognized market for public sale of futures in goods of the kind.

The provisions of paragraph (c) of subsection (4) are intended to permit intelligent bidding.

The provision of paragraph (d) of subsection (4) permitting the seller to bid and, of course, to become the purchaser, benefits the original buyer by tending to increase the resale price and thus decreasing the damages he will have to pay.

10. This Article [Chapter] departs in subsection (5) from the prior uniform statutory provision in permitting a good faith purchaser at resale to take a good title as against the buyer even though the seller fails to comply with the requirements of this section.

11. Under subsection (6), the seller retains profit, if any, without distinction based on whether or not he had a lien since this Article [Chapter] divorces the question of passage of title to the buyer from the seller's right of resale or the consequences of its exercise. On the other hand, where "a person in the position of a seller" or a buyer acting under the section on buyer's remedies, exercises his right of resale under the present section he does so only for the limited purpose of obtaining cash for his "security interest" in the goods. Once that purpose has been accomplished any excess in the resale price belongs to the seller to whom an accounting must be made as provided in the last sentence of subsection (6).

Cross References: Point 1: Sections 2-610, 2-702 and 2-703.

Point 2: Section 1-201.

Point 3: Sections 2-708 and 2-710.

Point 4: Section 2-328.

Point 8: Section 2-104.

Point 9: Section 2-710.

Point 11: Sections 2-401, 2-707 and 2-711(3).

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Contract for sale." Section 2-106.

"Good faith." Section 2-103.

"Goods." Section 2-105.

"Merchant." Section 2-104.

"Notification." Section 1-201.

"Person in position of seller." Section 2-707.

"Purchase." Section 1-201.

"Rights." Section 1-201.

"Sale." Section 2-106.

"Security interest." Section 1-201.

"Seller." Section 2-103.

§ 28-2-707. "Person in the position of a seller." — (1) A "person in the position of a seller" includes as against a principal an agent who has paid or become responsible for the price of goods on behalf of his principal or anyone who otherwise holds a security interest or other right in goods similar to that of a seller.

(2) A person in the position of a seller may as provided in this chapter withhold or stop delivery (section 28-2-705[, Idaho Code]) and resell (section 28-2-706[, Idaho Code]) and recover incidental damages (section 28-2-710[, Idaho Code]).

History.

1967, ch. 161, § 2-707, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (2) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

Official Comment

Prior Uniform Statutory Provision: Section 52(2), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that: In addition to following in general the prior uniform statutory provision, the case of a financing agency which has acquired documents by honoring a letter of credit for the buyer or by discounting a draft for the seller has been included in the term "a person in the position of a seller."

Cross Reference: Article [Chapter] 5, Section 2-506.

Definitional Cross References: "Consignee." Section 7-102.

"Consignor." Section 7-102.

"Goods." Section 2-105.

"Security interest." Section 1-201.

"Seller." Section 2-103.

§ 28-2-708. Seller's damages for nonacceptance or repudiation. — (1) Subject to subsection (2) and to the provisions of this chapter with respect to proof of market price (section 28-2-723[, Idaho Code]), the measure of damages for nonacceptance or repudiation by the buyer is the difference between the market price at the time and place for tender and the unpaid contract price together with any incidental damages provided in this chapter (section 28-2-710[, Idaho Code]), but less expenses saved in consequence of the buyer's breach.

(2) If the measure of damages provided in subsection (1) is inadequate to put the seller in as good a position as performance would have done then the measure of damages is the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages provided in this chapter (section 28-2-710[, Idaho Code]), due allowance for costs reasonably incurred and due credit for payments or proceeds of resale.

History.

1967, ch. 161, § 2-708, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (1) and (2) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Measure of Damages.

Where a buyer refuses to accept perishable property under a contract, it was the right of the seller to sell forthwith and reduce his damages. The

measure of damages was the estimated loss directly and naturally resulting, in the ordinary course of events, from buyer's breach of contract. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

Resale of Property.

Upon delivery and refusal to accept delivery of potatoes, seller had the right to resell the property, regardless of the fact that title had not passed to the buyer, and to recover damages for any loss sustained because of breach of contract, such potatoes being sold at the market price at the time of the resale, in this manner reducing his damages. Ore-Ida Potato Prods., Inc. v. Larsen, 83 Idaho 290, 362 P.2d 384 (1961).

Official Comment

Prior Uniform Statutory Provision: Section 64, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To make it clear that: 1. The prior uniform statutory provision is followed generally in setting the current market price at the time and place for tender as the standard by which damages for nonacceptance are to be determined. The time and place of tender is determined by reference to the section on manner of tender of delivery, and to the sections on the effect of such terms as FOB, FAS, CIF, C & F, Ex Ship and No Arrival, No Sale.

In the event that there is no evidence available of the current market price at the time and place of tender, proof of a substitute market may be made under the section on determination and proof of market price. Furthermore, the section on the admissibility of market quotations is intended to ease materially the problem of providing competent evidence.

2. The provision of this section permitting recovery of expected profit including reasonable overhead where the standard measure of damages is inadequate, together with the new requirement that price actions may be sustained only where resale is impractical, are designed to eliminate the unfair and economically wasteful results arising under the older law when fixed price articles were involved. This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods. The normal measure there would be list price less cost to the dealer

or list price less manufacturing cost to the manufacturer. It is not necessary to a recovery of "profit" to show a history of earnings, especially if a new venture is involved.

3. In all cases the seller may recover incidental damages.

Cross References: Point 1: Sections 2-319 through 2-324, 2-503, 2-723 and 2-724.

Point 2: Section 2-709.

Point 3: Section 2-710.

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Seller." Section 2-103.

§ 28-2-709. Action for the price. — (1) When the buyer fails to pay the price as it becomes due the seller may recover, together with any incidental damages under the next section, the price

(a) of goods accepted or of conforming goods lost or damaged within a commercially reasonable time after risk of their loss has passed to the buyer; and (b) of goods identified to the contract if the seller is unable after reasonable effort to resell them at a reasonable price or the circumstances reasonably indicate that such effort will be unavailing.

(2) Where the seller sues for the price he must hold for the buyer any goods which have been identified to the contract and are still in his control except that if resale becomes possible he may resell them at any time prior to the collection of the judgment. The net proceeds of any such resale must be credited to the buyer and payment of the judgment entitles him to any goods not resold.

(3) After the buyer has wrongfully rejected or revoked acceptance of the goods or has failed to make a payment due or has repudiated (section 28-2-610[, Idaho Code]), a seller who is held not entitled to the price under this section shall nevertheless be awarded damages for nonacceptance under the preceding section.

History.

1967, ch. 161, § 2-709, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in subsection (3) was added by the compiler to conform to the statutory citation style.

The words enclosed parentheses so appeared in the law as enacted.

CASE NOTES

Cited Industrial Leasing Corp. v. Thomason, 96 Idaho 574, 532 P.2d 916 (1974).

Decisions Under Prior Law

Implied contract for price.

Instructions.

Measure of damages.

Processing taxes.

Remedies for nonconformity.

Right of action.

When action lies.

Implied Contract for Price.

Seller's failure to supply part to a bean huller does not release buyer from payment, and does not create implied contract for sale at reasonable value, if the lack of the part was discovered before it was furnished and no rescission was claimed. West v. Prater, 57 Idaho 583, 67 P.2d 273 (1937).

Instructions.

Various instructions in action to recover contract price of pedigreed bulls were considered and held proper. McMaster v. Dunn, 49 Idaho 241, 287 P. 201 (1930).

Measure of Damages.

Measure of damages for refusal to purchase and pay on demand a note defendant agreed to purchase was the amount named as purchase price and not the difference between the market price and the contract price. Wallace Bank & Trust Co. v. First Nat'l Bank, 40 Idaho 712, 237 P. 284 (1925).

Where plaintiff alleged that he had sold and delivered to defendant, at his instance and request and upon his promise to pay, groceries and merchandise of the value of $871.43, of which amount $640 had been paid, and defendant failed to appear and answer, plaintiff was entitled to default judgment for $231.43 without proof of value of merchandise and groceries, since allegations were sufficient to show contract for payment of money. Starry v. Hamilton, 72 Idaho 313, 240 P.2d 824 (1952).

Processing Taxes.

The amount of processing tax paid by government under unconstitutional act as part of price of goods purchased by it under contract providing that, if taxes applicable to material on bid were imposed by congress after date set for opening of bid and paid by contractor, price would be increased or decreased accordingly, was recoverable by government from seller. United States v. Hagan, Cushing Co., 29 F. Supp. 564 (D. Idaho 1939), aff'd, 115 F.2d 849 (9th Cir. 1940).

Remedies for Nonconformity.

The purchaser who concluded that the article purchased was not what it was represented to be, or what he had a right to believe it was, or should be, cannot, after such discovery, go on using the article and, thereafter, refuse to pay the purchase price. He could, after such discovery, repudiate the contract, return the article, and demand return of any consideration paid, or retain the article and claim such damages as he may have sustained through breach of the contract by the vendor. Wilson v. Sunnyside Orchard Co., 33 Idaho 501, 196 P. 302 (1921); West v. Prater, 57 Idaho 583, 67 P.2d 273 (1937).

Right of Action.

Former law gave a right of action for the price, where the buyer had wrongfully refused to comply with the contract; if the buyer had not wrongfully refused, there would be no cause of action. Continental Jewelry Co. v. Ingelstrom, 43 Idaho 337, 252 P. 186 (1926).

Where the contract for sale of a vehicle contract did not create an enforceable security interest and creditor permitted debtor to take possession of the vehicle, a sale occurred and creditor's only right, as an unpaid seller without a legal security interest, was to sue debtor for the amount due under paragraph (1)(a) of this section. Hillen v. Dennis Dillon Auto Park & Truck Center, Inc. (In re Byrd), 546 B.R. 434 (Bankr. D. Idaho 2016).

When Action Lies.

Where contract was delivered conditionally, until conditions had been met, buyer was under no obligation to pay nor was delivery to carrier in

pursuance of contract a delivery to the buyer. Continental Jewelry Co. v. Ingelstrom, 43 Idaho 337, 252 P. 186 (1926).

Where buyer accepts goods to extent of using part of them in his business, seller may maintain action for entire shipment. Gross Mfg. Co. v. Redfield, 48 Idaho 399, 282 P. 487 (1929); Tweedie Footwear Corp. v. Roberts-Schofield Co., 48 Idaho 777, 285 P. 476 (1930).

RESEARCH REFERENCES

ALR. — Seller's recovery of price of goods from buyer under UCC § 2-709. 90 A.L.R.3d 1141.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Goods and Services: Distributorship, Franchise, and Similar Business Contracts. 8 A.L.R.7th 4.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Business Goods and Services: Manufacturing, Construction, and Similar Contracts. 15 A.L.R.7th 7.

Official Comment

Prior Uniform Statutory Provision: Section 63, Uniform Sales Act.

Changes: Rewritten, important commercially needed changes being incorporated.

Purposes of Changes: To make it clear that: 1. Neither the passing of title to the goods nor the appointment of a day certain for payment is now material to a price action.

2. The action for the price is now generally limited to those cases where resale of the goods is impracticable except where the buyer has accepted the goods or where they have been destroyed after risk of loss has passed to the buyer.

3. This section substitutes an objective test by action for the former "not readily resalable" standard. An action for the price under subsection (1) (b) can be sustained only after a "reasonable effort to resell" the goods "at reasonable price" has actually been made or where the circumstances "reasonably indicate" that such an effort will be unavailing.

4. If a buyer is in default not with respect to the price, but on an obligation to make an advance, the seller should recover not under this section for the price as such, but for the default in the collateral (though coincident) obligation to finance the seller. If the agreement between the parties contemplates that the buyer will acquire, on making the advance, a security interest in the goods, the buyer on making the advance has such an interest as soon as the seller has rights in the agreed collateral. See Section 9-204.

5. "Goods accepted" by the buyer under subsection (1) (a) include only goods as to which there has been no justified revocation of acceptance, for such a revocation means that there has been a default by the seller which bars his rights under this section. "Goods lost or damaged" are covered by the section on risk of loss. "Goods identified to the contract" under subsection (1) (b) are covered by the section on identification and the section on identification notwithstanding breach.

6. This section is intended to be exhaustive in its enumeration of cases where an action for the price lies.

7. If the action for the price fails, the seller may nonetheless have proved a case entitling him to damages for nonacceptance. In such a situation, subsection (3) permits recovery of those damages in the same action.

Cross References: Point 4: Section 1-106.

Point 5: Sections 2-501, 2-509, 2-510 and 2-704.

Point 7: Section 2-708.

Definitional Cross References: "Action." Section 1-201.

"Buyer." Section 2-103.

"Conforming." Section 2-106.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Seller." Section 2-103.

§ 28-2-710. Seller's incidental damages. — Incidental damages to an aggrieved seller include any commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of goods after the buyer's breach, in connection with return or resale of the goods or otherwise resulting from the breach.

History.

1967, ch. 161, § 2-710, p. 351.

CASE NOTES

Interest.

Interest expenses caused by a buyer's breach may be compensable as incidental damages under this section, where there is a direct nexus between the buyer's breach and the seller's costs with respect to the goods, such as where the seller incurs interest on money borrowed to produce or acquire the goods sold to the buyer; however, interest expenses caused by borrowing money to defray the general expenses of closing the business involve no such nexus and may not be recovered as incidental damages. MH & H Implement, Inc. v. Massey-Ferguson, Inc., 108 Idaho 879, 702 P.2d 917 (Ct. App. 1985).

Decisions Under Prior Law Special Damages.

In suit which alleged that heating equipment and accessories as supplied and warranted were wholly insufficient for heating respondent's home and sought the cancelation of two contracts and the return to them of the amount paid as purchase price under the contracts, together with costs of the suit and general relief, an offered amendment by respondent's referring to special damages allegedly resulting directly from breach of warranty involved would have been proper for the court to have considered to show special damages resulting from the necessity to purchase excessive amounts of fuel. Mowers v. Holland Furnace Co., 81 Idaho 208, 339 P.2d 663 (1959).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 902 et seq.

Official Comment Prior Uniform Statutory Provision: See Sections 64 and 70, Uniform Sales Act.

Purposes: To authorize reimbursement of the seller for expenses reasonably incurred by him as a result of the buyer's breach. The section sets forth the principal normal and necessary additional elements of damage flowing from the breach but intends to allow all commercially reasonable expenditures made by the seller.

Definitional Cross References: "Aggrieved party." Section 1-201.

"Buyer." Section 2-103.

"Goods." Section 2-105.

"Seller." Section 2-103.

§ 28-2-711. Buyer's remedies in general — Buyer's security interest in rejected goods. — (1) Where the seller fails to make delivery or repudiates or the buyer rightfully rejects or justifiably revokes acceptance then with respect to any goods involved, and with respect to the whole if the breach goes to the whole contract (section 28-2-612[, Idaho Code]), the buyer may cancel and whether or not he has done so may in addition to recovering so much of the price as has been paid

(a) "cover" and have damages under the next section as to all the goods affected whether or not they have been identified to the contract; or (b) recover damages for nondelivery as provided in this chapter (section 28-2-713[, Idaho Code]).

(2) Where the seller fails to deliver or repudiates the buyer may also (a) if the goods have been identified recover them as provided in this chapter (section 28-2-502[, Idaho Code]); or (b) in a proper case obtain specific performance or replevy the goods as provided in this chapter (section 28-2-716[, Idaho Code]).

(3) On rightful rejection or justifiable revocation of acceptance a buyer has a security interest in goods in his possession or control for any payments made on their price and any expenses reasonably incurred in their inspection, receipt, transportation, care and custody and may hold such goods and resell them in like manner as an aggrieved seller (section 28-2-706[, Idaho Code]).

History.

1967, ch. 161, § 2-711, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions throughout this section were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Cancellation.

Rescission and revocation of acceptance amount to the same thing under the Uniform Commercial Code, particularly since cancellation is a remedy available to a buyer who has established justifiable grounds for revocation of acceptance. Peckham v. Larsen Chevrolet-Buick-Oldsmobile, Inc., 99 Idaho 675, 587 P.2d 816 (1978).

Damages.

There was no error in magistrate's decision to offset the deposit for used engine against damages awarded to buyers for breach of implied warranty of merchantability and implied warranty of fitness for a particular purpose; buyer did not have to return the engine and seller was in no worse position than if buyers had resold the engine and deducted the resale price from their damages. Berning v. Drumwright, 122 Idaho 203, 832 P.2d 1138 (Ct. App. 1992).

Where a buyer and seller entered into a contract for the sale of logs to be used by the buyer in the construction of a log cabin, and the seller breached the contract by failing to deliver the logs within a reasonable time, so that the buyer had to purchase the logs from another supplier in order to complete her cabin, the trial court properly awarded damages for the buyer's cost of cover. Borah v. McCandless, 147 Idaho 73, 205 P.3d 1209 (2009).

When a buyer rightfully rejects goods, the buyer can either cover, and recover as damages the difference between the cost of cover and the

contract price, or recover as damages the difference between the market price and the contract price. Panike & Sons Farms, Inc. v. Smith, 147 Idaho 562, 212 P.3d 992 (2009).

Manufacturer.

Subsection (1) does not allow purchasers of an allegedly defective motor home with a limited warranty to pursue a refund claim against the manufacturer. That remedy is only available against the seller. Miller v. Four Winds Int'l Corp., 827 F. Supp. 2d 1175 (D. Idaho 2011).

Remedy for Breach of Warranty of Merchantability.

The court-imposed remedy for the breach of the warranty of merchantability in the sale of a copy machine, which included return of the machine, recovery of the purchase price, and cost of chemicals, was appropriate. Lee v. Peterson, 110 Idaho 601, 716 P.2d 1373 (Ct. App. 1986).

Rescission or Waiver.

Where a buyer accepted a refund of the deposit he had given the seller, the buyer simply received so much of the price as he had paid and he was still entitled to his additional remedies upon the seller's breach of their purchase agreement; the buyer's acceptance of the refund did not amount to a rescission or a waiver of his rights. Palmer v. Idaho Peterbilt, Inc., 102 Idaho 800, 641 P.2d 346 (Ct. App. 1982).

Revocation of Acceptance.

Buyers revoked their acceptance of second-hand engine installed by mechanic, where the record clearly showed that a defect in the engine substantially impaired its value and that the buyers retained possession of it while reasonably assuming that mechanic would repair the engine. Berning v. Drumwright, 122 Idaho 203, 832 P.2d 1138 (Ct. App. 1992).

Buyer could rightfully revoke acceptance given the nonconformity of the machine and seller's failure to remedy the damage. Beal v. Griffin, 123 Idaho 445, 849 P.2d 118 (Ct. App. 1993).

Because a buyer may revoke acceptance only against the seller and because a finding that the purchasers had the right to revoke acceptance against automobile dealer is consistent with a finding that the dealer had not breached any warranties, jury verdict for purchasers was not inconsistent

and was permissible on revocation claim against dealer and on the lemon law claim against automobile manufacturer. Griffith v. Latham Motors, Inc., 128 Idaho 356, 913 P.2d 572 (1996).

Specific Performance.

Lower court had authority to order interim payments be made by tenant/alleged purchaser to landlord/alleged vendor during pendency of the action because landlord/alleged vendor's willingness to accept payments until conclusion of action satisfied requirement of specific performance that all conditions precedent to the other party's duty to perform had been satisfied. Hinkle v. Winey, 126 Idaho 993, 895 P.2d 594 (Ct. App. 1995).

Cited Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983); Fernandez v. Western R.R. Bldrs., 112 Idaho 907, 736 P.2d 1361 (Ct. App. 1987).

Decisions Under Prior Law

Waiver of breach of warranty.

Amount of Damages.

The buyer who sought to recover damages for breach of warranty must have established the amount of the damages sustained by competent evidence. Nelson v. Intermountain Farmers Equity, 36 Idaho 518, 211 P. 550 (1922).

In actions of fraud and actions for breach of warranty the measure of damages was the difference between the price paid and the reasonable market value of the article at the time of sale, the purpose being to limit recovery to loss actually sustained by the buyer, thus preventing recovery of speculative profits. Jesse M. Chase, Inc. v. Leonard, 69 Idaho 109, 203 P.2d 600 (1949).

In a complaint for breach of warranty in sale of explosives for use in excavation for sewer, an allegation "that plaintiff had to remove rock by mechanical means at a great expense to his damage" was not sufficient pleading of the measure of damages. Coleman v. Carter, 77 Idaho 210, 289 P.2d 932 (1955).

Defense of Breach of Warranty.

In action to recover possession of certain bread-wrapping machine, defendant could set up defense of, and cross-complaint for, breach of warranty. W.H. Bintz Co. v. Mueggler, 65 Idaho 760, 154 P.2d 513 (1944).

Delay Caused or Induced by Seller.

Delay in giving notice of rescission did not destroy the right of the buyer where the delay was due to the representations of the seller. Morton v. Whitson, 45 Idaho 28, 260 P. 426 (1927).

Difference in Values.

Breach of warranty in conditional sales contract, as to number of loaves of bread which bread-wrapping machine, covered by contract, would wrap per hour, was equivalent to partial failure of consideration. W.H. Bintz Co. v. Mueggler, 65 Idaho 760, 154 P.2d 513 (1944).

If buyer elects to retain machine contracted for and bring an action for breach of warranty of quality, he was entitled to recover the difference

between the value of machine at the time of delivery to the buyer and the value the machine would have had if seller had answered to the warranty, plus any special damages alleged and proved. Sanchotena v. Tower Co., 74 Idaho 541, 264 P.2d 1021 (1953).

In suit by buyer to recover damages for breach of warranty that pump purchased would produce specific amount of water for use on crops, the buyer was not entitled to a new trial on ground that jury failed to award him damages for difference in value of pump contracted for and value of pump delivered, when there was no evidence on value of pump. Sanchotena v. Tower Co., 74 Idaho 541, 264 P.2d 1021 (1953).

Enhancement of Damages.

The damages suffered by the buyer in consequence of the breach of an implied warranty of fitness could not have been enhanced by any act of his subsequent to learning of the breach of warranty. Tomita v. Johnson, 49 Idaho 643, 290 P. 395 (1930).

Failure of Consideration.

To entitle buyer to recover damages for breach of contract by seller, buyer need not allege or prove a complete failure of consideration, but a partial failure of consideration was sufficient. C.I.T. Corp. v. Elliott, 66 Idaho 384, 159 P.2d 891 (1945).

Implied Warranty of Suitability.

Where one desiring seed made known to a dealer his needs for planting, and a selection was made upon recommendation by the seller, there arose an implied warranty that the seed was suitable for the purposes intended. Tomita v. Johnson, 49 Idaho 643, 290 P. 395 (1930).

Implied warranties for quality or fitness were coextensive. National Motor Serv. Co. v. Walters, 85 Idaho 349, 379 P.2d 643 (1963).

Instructions to Jury.

Instruction which embodied provision of former statute prescribing remedies of buyer in case of breach of warranty, taken in connection with other instructions given, was held proper in action on contract for sale of onions to defendant. Walker v. Idaho Lettuce Co., 44 Idaho 478, 258 P. 931 (1927).

Loss Directly and Naturally Resulting.

A purchaser of bread-wrapping machine was entitled to recover from seller damages sustained because of seller's breach of warranty, as to number of loaves of bread which machine would wrap per hour, from time of installation thereof until purchaser's installation of new bread pans, which seller's agent advised purchaser would rectify defects in machine, but not for damage sustained during period for which purchaser continued to operate machine after installation of such pans, which failed to remedy defects. W.H. Bintz Co. v. Mueggler, 65 Idaho 760, 154 P.2d 513 (1944).

Making Use or Disposing of Goods.

There could be no rescission by a buyer who continued to use machinery purchased for eighty days after discovery of its defects, without returning or offering to return it; and the fact that he had not completed the work he had contracted to do with such machinery is no excuse for not promptly acting on his election to rescind. Troendly v. J.I. Case Co., 50 Idaho 506, 297 P. 1103 (1931).

Questions of Law and Fact.

Whether fact that seller refused to replace stallion which proved unsatisfactory with another imported or pure-bred stallion of equal quality, as required by guaranty, unless buyer would pay substantial sum for making the exchange, rendered unnecessary buyer's compliance with terms of contract regarding return of stallion in case it should prove unsatisfactory, was for jury. Thiessen Land Co. v. Metz Livestock Co., 61 Idaho 161, 99 P.2d 50 (1940).

Reliance on Oral Representations.

The exaction of a warranty covering the alleged fraudulent representations made prior to the execution of the contract, where the evidence failed to show that the seller was guilty of any artifice to prevent the purchaser from examining and judging for himself, indicated an intention to rely on the warranty, and no action could be predicated upon the oral representations. Troendly v. J.I. Case Co., 50 Idaho 506, 297 P. 1103 (1931).

Rescission or Recovery of Damages.

The purchaser who concluded that the article purchased is not what it was represented to be, or what he had a right to believe it was or should be, could not, after such discovery, go on using the article and, thereafter, refuse to pay the purchase price; but he could, after such discovery, repudiate the contract, return the article, and demand return of any consideration paid, which was a rescission, or he could retain the article and claim such damages as he has sustained through breach of the contract by the vendor. Wilson v. Sunnyside Orchard Co., 33 Idaho 501, 196 P. 302 (1921); West v. Prater, 57 Idaho 583, 67 P.2d 273 (1937).

The phrase "other legal remedy" as used in former statute, providing that the acceptance of goods by the buyer shall not discharge the seller from liability in damages or other legal remedy for breach of any promise or warranty in the contract to sell or the sale, in the absence of an express or implied agreement of the parties, included the buyer's right of rescission. Baker v. J.C. Watson Co., 64 Idaho 573, 134 P.2d 613 (1943).

Return of Goods.

Buyer of an article could retain the article and claim such damages as he has sustained through breach of contract by the seller, and it was not necessary to recovery of damages that buyer return article. C.I.T. Corp. v. Elliott, 66 Idaho 384, 159 P.2d 891 (1945).

Under former statute, a buyer may return the article purchased and recover back all money paid on the purchase price without reimbursing the seller for the use of the article between the time of its purchase and such return. J.I. Case Credit Corp. v. Andreason, 90 Idaho 12, 408 P.2d 165 (1965).

Time of Accrual of Cause of Action.

A right of action in damages for breach of warranty accrued at the time it was ascertained by the purchaser that the article was not as represented. Tomita v. Johnson, 49 Idaho 643, 290 P. 395 (1930).

Waiver of Breach of Warranty.

Where one purchased a mortgaged chattel, with the consent of the mortgagee, under agreement to pay purchase price to mortgagee's agent, and took over mortgaged chattels and consumed them, any claim of breach

of seller's warranty of quality was waived. First Nat'l Bank v. Peterson, 47 Idaho 794, 279 P. 302 (1929).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 1034 et seq.

68A Am. Jur. 2d, Secured Transactions, § 546 et seq.

Official Comment

Prior Uniform Statutory Provision: No comparable index section; Subsection (3) — Section 69(5), Uniform Sales Act.

Changes: The prior uniform statutory provision is generally continued and expanded in Subsection (3).

Purposes of Changes and New Matter: 1. To index in this section the buyer's remedies, subsection (1) covering those remedies permitting the recovery of money damages, and subsection (2) covering those which permit reaching the goods themselves. The remedies listed here are those available to a buyer who has not accepted the goods or who has justifiably revoked his acceptance. The remedies available to a buyer with regard to goods finally accepted appear in the section dealing with breach in regard to accepted goods. The buyer's right to proceed as to all goods when the breach is as to only some of the goods is determined by the section on breach in installment contracts and by the section on partial acceptance.

Despite the seller's breach, proper retender of delivery under the section on cure of improper tender or replacement can effectively preclude the buyer's remedies under this section, except for any delay involved.

2. To make it clear in subsection (3) that the buyer may hold and resell rejected goods if he has paid a part of the price or incurred expenses of the type specified. "Paid" as used here includes acceptance of a draft or other time negotiable instrument or the signing of a negotiable note. His freedom of resale is coextensive with that of a seller under this Article [Chapter] except that the buyer may not keep any profit resulting from the resale and is limited to retaining only the amount of the price paid and the costs involved in the inspection and handling of the goods. The buyer's security

interest in the goods is intended to be limited to the items listed in subsection (3), and the buyer is not permitted to retain such funds as he might believe adequate for his damages. The buyer's right to cover, or to have damages for nondelivery, is not impaired by his exercise of his right of resale.

3. It should also be noted that this Act requires its remedies to be liberally administered and provides that any right or obligation which it declares is enforceable by action unless a different effect is specifically prescribed (Section 1-106).

Cross References: Point 1: Sections 2-508, 2-601(c), 2-608, 2-612 and 2-714.

Point 2: Section 2-706.

Point 3: Section 1-106.

Definitional Cross References: "Aggrieved party." Section 1-201.

"Buyer." Section 2-103.

"Cancellation." Section 2-106.

"Contract." Section 1-201.

"Cover." Section 2-712.

"Goods." Section 2-105.

"Notifies." Section 1-201.

"Receipt" of goods. Section 2-103.

"Remedy." Section 1-201.

"Security interest." Section 1-201.

"Seller." Section 2-103.

§ 28-2-712. “Cover” — Buyer’s procurement of substitute goods. — (1) After a breach within the preceding section the buyer may “cover” by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller.

(2) The buyer may recover from the seller as damages the difference between the cost of cover and the contract price together with any incidental or consequential damages as hereinafter defined (section 28-2-715[, Idaho Code]), but less expenses saved in consequence of the seller’s breach.

(3) Failure of the buyer to effect cover within this section does not bar him from any other remedy.

History.

1967, ch. 161, § 2-712, p. 351.

STATUTORY NOTES

Compiler’s Notes.

The bracketed insertion near the end of subsection (2) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Timely Seeking Cover.

Where plaintiff admitted that it began seeking cover months before defendant’s alleged breach, plaintiff was not entitled to recover its cost of cover. Magic Valley Foods, Inc. v. Sun Valley Potatoes, Inc., 134 Idaho 785, 10 P.3d 734 (2000).

Cited Panike & Sons Farms, Inc. v. Smith, 147 Idaho 562, 212 P.3d 992 (2009).

RESEARCH REFERENCES

ALR. — What constitutes "cover" upon breach by seller under UCC § 2-712(1). 79 A.L.R.4th 844.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. This section provides the buyer with a remedy aimed at enabling him to obtain the goods he needs thus meeting his essential need. This remedy is the buyer's equivalent of the seller's right to resell.

2. The definition of "cover" under subsection (1) envisages a series of contracts or sales, as well as a single contract or sale; goods not identical with those involved but commercially usable as reasonable substitutes under the circumstances of the particular case; and contracts on credit or delivery terms differing from the contract in breach, but again reasonable under the circumstances. The test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable manner, and it is immaterial that hindsight may later prove that the method of cover used was not the cheapest or most effective.

The requirement that the buyer must cover "without unreasonable delay" is not intended to limit the time necessary for him to look around and decide as to how he may best effect cover. The test here is similar to that generally used in this Article [Chapter] as to reasonable time and seasonable action.

3. Subsection (3) expresses the policy that cover is not a mandatory remedy for the buyer. The buyer is always free to choose between cover and damages for nondelivery under the next section.

However, this subsection must be read in conjunction with the section which limits the recovery of consequential damages to such as could not have been obviated by cover. Moreover, the operation of the section on specific performance of contracts for "unique" goods must be considered in this connection for availability of the goods to the particular buyer for his particular needs is the test for that remedy and inability to cover is made an express condition to the right of the buyer to replevy the goods.

4. This section does not limit cover to merchants, in the first instance. It is the vital and important remedy for the consumer buyer as well. Both are free to use cover: the domestic or nonmerchant consumer is required only to act in normal good faith while the merchant buyer must also observe all reasonable commercial standards of fair dealing in the trade, since this falls within the definition of good faith on his part.

Cross References: Point 1: Section 2-706.

Point 2: Section 1-204 [1-205].

Point 3: Sections 2-713, 2-715 and 2-716.

Point 4: Section 1-203.

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Good faith." Section 2-103.

"Goods." Section 2-105.

"Purchase." Section 1-201.

"Remedy." Section 1-201.

"Seller." Section 2-103.

§ 28-2-713. Buyer's damages for nondelivery or repudiation. — (1) Subject to the provisions of this chapter with respect to proof of market price (section 28-2-723[, Idaho Code]), the measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with any incidental and consequential damages provided in this chapter (section 28-2-715[, Idaho Code]), but less expenses saved in consequence of the seller's breach.

(2) Market price is to be determined as of the place for tender or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival.

History.

1967, ch. 161, § 2-713, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (1) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Applicability.

Buyer could not have recovered damages from a debtor's partners under this section because the partners were not the sellers under the original contract; that role was played by the debtor, and the buyer had

acknowledged the fact. In re Morton, 2009 Bankr. LEXIS 1518 (Bankr. D. Idaho June 9, 2009).

Measure of Damages.

Where parties contracted for sale of wheat and left the basis figure open to be agreed upon at a later date, where on September 6, defendant notified plaintiff that he was not going to deliver the wheat subject to a 14% basis figure but continued to communicate with plaintiff and was apparently still willing to sell to plaintiff and on November 6, notified plaintiff that he had sold the wheat to a third party, the finding of the trial court that the breach occurred on November 6, was supported by substantial and competent evidence; therefore the proper standard for damages for nondelivery of the grain was the difference between the market price on November 6, and the contract price. D.R. Curtis Co. v. Mathews, 103 Idaho 776, 653 P.2d 1188 (Ct. App. 1982).

In a breach of express warranty case, there was no contention that the market price for a seven ton dehumidifier of the type described in the parties' contract was higher than the contract price for that dehumidifier; therefore, the only damages the owners of an athletic club were entitled to recover were incidental and consequential damages, and the district court's damage award had to be reduced by $10,659. Keller v. Inland Metals All Weather Conditioning, Inc., 139 Idaho 233, 76 P.3d 977 (2003).

When a buyer rightfully rejects goods, the buyer can either cover and recover as damages the difference between the cost of cover and the contract price or recover, as damages, the difference between the market price and the contract price. Panike & Sons Farms, Inc. v. Smith, 147 Idaho 562, 212 P.3d 992 (2009).

Time of Repudiation.

Where the seller of a truck sent a letter to the buyer enclosing a refund of the buyer's cash deposit and stating in a clear and unequivocal manner that no performance would be forthcoming from the seller, the buyer no longer had a reasonable expectation of performance by the seller, and the time of the repudiation of the contract by the seller was the time of the breach to be used in determining the market price of the truck. Palmer v. Idaho Peterbilt, Inc., 102 Idaho 800, 641 P.2d 346 (Ct. App. 1982).

Cited Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977); 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978); Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Decisions Under Prior Law

Consequential Damages.

Consequential damages, consisting of lost or prospective profits, must grow out of circumstances made known to seller at time of entering into the contract. Bowman v. Adams, 45 Idaho 217, 261 P. 679 (1927).

Damages for Unique Chattel.

Even when a chattel was special and unique, if its pecuniary value could have been readily ascertained, so that the remedy of damages was adequate, specific performance would not be granted. Bowman v. Adams, 45 Idaho 217, 261 P. 679 (1927).

Measure of Damages.

Where one party contracted to sell seed of a given kind to another, but the seller did not furnish the seed and the buyer could not buy the seed elsewhere, the measure of damages was the difference between the net value of the crop which would have been raised, had the seed contracted for been furnished, and the net value of the crop actually produced. Tingwall v. Wilson, 50 Idaho 452, 296 P. 1017 (1931).

Official Comment

Prior Uniform Statutory Provision: Section 67(3), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: To clarify the former rule so that: 1. The general baseline adopted in this section uses as a yardstick the market in which the buyer would have obtained cover had he sought that relief. So the place for

measuring damages is the place of tender (or the place of arrival if the goods are rejected or their acceptance is revoked after reaching their destination) and the crucial time is the time at which the buyer learns of the breach.

2. The market or current price to be used in comparison with the contract price under this section is the price for goods of the same kind and in the same branch of trade.

3. When the current market price under this section is difficult to prove the section on determination and proof of market price is available to permit a showing of a comparable market price or, where no market price is available, evidence of spot sale prices is proper. Where the unavailability of a market price is caused by a scarcity of goods of the type involved, a good case is normally made for specific performance under this Article [Chapter]. Such scarcity conditions, moreover, indicate that the price has risen and under the section providing for liberal administration of remedies, opinion evidence as to the value of the goods would be admissible in the absence of a market price and a liberal construction of allowable consequential damages should also result.

4. This section carries forward the standard rule that the buyer must deduct from his damages any expenses saved as a result of the breach.

5. The present section provides a remedy which is completely alternative to cover under the preceding section and applies only when and to the extent that the buyer has not covered.

Cross References: Point 3: Sections 1-106, 2-716, and 2-723.

Point 5: Section 2-712.

Definitional Cross References: "Buyer." Section 2-103.

"Contract." Section 1-201.

"Seller." Section 2-103.

§ 28-2-714. Buyer's damages for breach in regard to accepted goods. — (1) Where the buyer has accepted goods and given notification (subsection (3) of section 28-2-607[, Idaho Code]) he may recover as damages for any nonconformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable.

(2) The measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount.

(3) In a proper case any incidental and consequential damages under the next section may also be recovered.

History.

1967, ch. 161, § 2-714, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in subsection (1) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Revocation of acceptance.

Special circumstances.

Breach of Express Warranty.

The trial court's denial of the breach of express warranty as a basis for recovery was error, where seller had expressly warranted that its clay would be equal to or better than an alternative supplier's clay. Figueroa v. Kit-San Co., 123 Idaho 149, 845 P.2d 567 (Ct. App. 1992).

Damages Recoverable.

Where the defendant building supply company was found to have breached an implied warranty of merchantability in the sale of paneling to the plaintiff homeowner, the cost of replacement paneling was recoverable under subsection (2) of this section. The additional costs of removing the existing paneling and installing the new paneling were recoverable as incidental damages under § 28-2-715(1) and subsection (3) of this section. Duff v. Bonner Bldg. Supply, Inc., 103 Idaho 432, 649 P.2d 391 (Ct. App. 1982), aff'd, 105 Idaho 123, 666 P.2d 650 (1983).

Measure of Damages.

The cost of repair is a proper measure of the difference in value between the goods as warranted and as accepted and, therefore, is recoverable under subsection (2) of this section in breach of warranty cases. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Where buyer bought a car from seller, drove it for 18 months, and then it was discovered the car had been stolen, buyer was not entitled to a refund of the whole purchase price of the car, but only the amount of its trade-in value which he actually lost. De Weber v. Bob Rice Ford, Inc., 99 Idaho 847, 590 P.2d 103 (1979).

Prejudgment Interest.

In a breach of warranty case where damages are a measure of cost of replacement, prejudgment interest should accrue from the date that the product's failure required that the product be replaced. Meldco, Inc. v. Hollytex Carpet Mills, Inc., 118 Idaho 265, 796 P.2d 142 (Ct. App. 1990).

Purpose.

The purpose of this section is to provide for the recovery of the buyer's loss resulting from the seller's breach. De Weber v. Bob Rice Ford, Inc., 99 Idaho 847, 590 P.2d 103 (1979).

Remedy Not Limited.

Although § 28-2-711(1) does not allow purchasers of an allegedly defective motor home with a limited warranty to pursue a refund claim against the manufacturer, a showing of special circumstances under § 28-2-719(2) and this section might allow the purchasers to avoid the general measure of damages. Miller v. Four Winds Int'l Corp., 827 F. Supp. 2d 1175 (D. Idaho 2011).

Revocation of Acceptance.

Because a buyer may revoke acceptance only against the seller and because a finding that the purchasers had the right to revoke acceptance against automobile dealer is consistent with a finding that the dealer had not breached any warranties, jury verdict for purchasers was not inconsistent and was permissible on revocation claim against dealer and on the lemon law claim against automobile manufacturer. Griffith v. Latham Motors, Inc., 128 Idaho 356, 913 P.2d 572 (1996).

Special Circumstances.

If mobile home buyers were unable to prove the amount of loss in value caused by the breaches of warranty, such would constitute a "special circumstance" which might enable them to recover on an alternate measure of damages. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Cited Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978); Farmers Nat'l Bank v. Wickham Pipeline Constr., 114 Idaho 565, 759 P.2d 71 (1988); Powers v. Am. Honda Motor Co., 139 Idaho 333, 79 P.3d 154 (2003).

Decisions Under Prior Law

Enhancement of Damages.

The damages suffered by a buyer in consequence of breach of an implied warranty of fitness could not be enhanced by any act of his subsequent to

learning of the breach of warranty. Tomita v. Johnson, 49 Idaho 643, 290 P. 395 (1930).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 1034 et seq.

ALR. — Measure of damages in action for breach of warranty of title to personal property under UCC § 2-714. 94 A.L.R.3d 583.

Official Comment

Prior Uniform Statutory Provision: Section 69(6) and (7), Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes: 1. This section deals with the remedies available to the buyer after the goods have been accepted and the time for revocation of acceptance has gone by. In general this section adopts the rule of the prior uniform statutory provision for measuring damages where there has been a breach of warranty as to goods accepted, but goes further to lay down an explicit provision as to the time and place for determining the loss.

The section on deduction of damages from price provides an additional remedy for a buyer who still owes part of the purchase price, and frequently the two remedies will be available concurrently. The buyer's failure to notify of his claim under the section on effects of acceptance, however, operates to bar his remedies under either that section or the present section.

2. The "nonconformity" referred to in subsection (1) includes not only breaches of warranties but also any failure of the seller to perform according to his obligations under the contract. In the case of such nonconformity, the buyer is permitted to recover for his loss "in any manner which is reasonable."

3. Subsection (2) describes the usual, standard and reasonable method of ascertaining damages in the case of breach of warranty but it is not intended as an exclusive measure. It departs from the measure of damages for nondelivery in utilizing the place of acceptance rather than the place of tender. In some cases the two may coincide, as where the buyer signifies his

acceptance upon the tender. If, however, the nonconformity is such as would justify revocation of acceptance, the time and place of acceptance under this section is determined as of the buyer's decision not to revoke.

4. The incidental and consequential damages referred to in subsection (3), which will usually accompany an action brought under this section, are discussed in detail in the comment on the next section.

Cross References: Point 1: Compare Section 2-711; Sections 2-607 and 2-717.

Point 2: Section 2-106.

Point 3: Sections 2-608 and 2-713.

Point 4: Section 2-715.

Definitional Cross References: "Buyer." Section 2-103.

"Conform." Section 2-106.

"Goods." Section 1-201.

"Notification." Section 1-201.

"Seller." Section 2-103.

§ 28-2-715. Buyer's incidental and consequential damages. — (1) Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.

(2) Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and (b) injury to person or property proximately resulting from any breach of warranty.

History.

1967, ch. 161, § 2-715, p. 351.

CASE NOTES

Amount of Damages.

Where the seller breached a contract to sell a truck to the buyer, and the seller knew that the buyer intended to use the truck in his business, with

specially adapted trailers, the buyer could recover any proven actual losses resulting from the buyer's inability to use the trailers. Palmer v. Idaho Peterbilt, Inc., 102 Idaho 800, 641 P.2d 346 (Ct. App. 1982).

If subcontractor's successor had reason to know that contractor faced exposure for liquidated damages in the event of a breach by subcontractor's successor, then payment of liquidated damages could properly be considered as proof of contractor's consequential damages, stemming from subcontractor's successor's breach of contract. As such, it was for the jury to determine whether subcontractor's successor did foresee, or should have foreseen, the liquidated damages as an injury to contractor in the event of a breach by subcontractor's successor. Cannon Bldrs., Inc. v. Rice, 126 Idaho 616, 888 P.2d 790 (Ct. App. 1995).

In a breach of express warranty case, there was no contention that the market price for a seven ton dehumidifier of the type described in the parties' contract was higher than the contract price for that dehumidifier; therefore, the only damages the owners of an athletic club were entitled to recover were incidental and consequential damages, and the district court's damage award had to be reduced by $10,659. Keller v. Inland Metals All Weather Conditioning, Inc., 139 Idaho 233, 76 P.3d 977 (2003).

Burden of Proof.

The damages recoverable under subsection (2)(a) of this section, like other damages recoverable for breach of contract, must be established with reasonable certainty. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Under this section the plaintiffs were only required to take reasonable efforts to mitigate their damages, and the burden of proving that the damages could have been minimized was on the defendants. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Damages Recoverable.

Where the defendant building supply company was found to have breached an implied warranty of merchantability in the sale of paneling to the plaintiff homeowner, the cost of replacement paneling was recoverable under § 28-2-714(2). The additional costs of removing the existing paneling and installing the new paneling were recoverable as incidental damages

under § 28-2-714(3) and this section. Duff v. Bonner Bldg. Supply, Inc., 103 Idaho 432, 649 P.2d 391 (Ct. App. 1982), aff'd, 105 Idaho 123, 666 P.2d 650 (1983).

Where storage company bought wheat from seller to process into seed for resale, and where jury found that seller had reason to know that wheat was to be sold as spring wheat seed and that buyer did as much as was reasonably necessary to mitigate its damages, buyer was entitled to recover consequential damages for its loss in reimbursing customers for damages that they suffered by planting the seed, which turned out not to be spring wheat seed but a mixture of spring and winter wheat. Nezperce Storage Co. v. Zenner, 105 Idaho 464, 670 P.2d 871 (1983).

Foreseeability.

Where the special interrogatories returned by the jury indicated that seller of wheat was aware of the shortage of spring wheat seed in the area and had reason to realize that buyer's purpose in purchasing wheat was to meet such shortage and that seller had reason to know that buyer was purchasing the wheat to process it into spring wheat seed for resale, the foreseeability requirement of subdivision (2)(a) of this section was satisfied. Nezperce Storage Co. v. Zenner, 105 Idaho 464, 670 P.2d 871 (1983).

Loss.

Grain storage company clearly sustained a "loss," within the meaning of subdivision (2)(a) of this section, in reimbursing its customers for the damages they suffered by purchasing and planting seed which was believed to be, but was not, spring wheat. In a breach of warranty action, indemnification for this kind of loss is proper, when a seller receives a warranty from a supplier and passes that warranty on to customers. Nezperce Storage Co. v. Zenner, 105 Idaho 464, 670 P.2d 871 (1983).

Mitigation of Damages.

The question of whether buyer of wheat acted properly to mitigate its damages was a factual matter to be determined by the trier of the fact and where the jury specifically found it was reasonable for buyer to sell the seed it manufactured from the wheat to its customers without doing any more than it did to determine whether or not such seed was actually of a spring wheat variety, such finding was supported by substantial, albeit conflicting,

testimony and would not be disturbed on appeal. Nezperce Storage Co. v. Zenner, 105 Idaho 464, 670 P.2d 871 (1983).

Personal Injury Damages.

The UCC does provide for recovery of damages for personal injuries under its breach of warranty provisions. However, UCC breach of warranty actions for personal injuries are available only to a limited group of potential plaintiffs who are either in privity of contract with the manufacturer or seller, or who qualify as third party beneficiaries of the underlying sales contract, as defined in § 28-2-318. Oats v. Nissan Motor Corp., 126 Idaho 162, 879 P.2d 1095 (1994).

Recovery for Loss of Profits.

This section only limits the buyer's right to loss of profits when cover is possible, and, if substitute goods cannot be purchased, the buyer is entitled to loss of profits. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

Where the buyer under a contract for the sale of steel pipe was unable to cover its losses following the seller's default because of a shortage of steel pipe at that time, the buyer could recover for its loss of profits. Southern Idaho Pipe & Steel Co. v. Cal-Cut Pipe & Supply, Inc., 98 Idaho 495, 567 P.2d 1246 (1977), cert. denied and appeal dismissed, 434 U.S. 1056, 98 S. Ct. 1225, 55 L. Ed. 2d 757 (1978).

Although prospective profits hoped to be derived from a business which is not yet established but merely in contemplation are ordinarily too speculative to be recoverable, a plaintiff is not categorically denied the right to recover lost profits simply because he is engaged in a relatively new business: the pivotal question is not whether the plaintiff has proven an established earning record but whether he has proven the damages for lost profits with reasonable certainty, although the former is often relevant to the latter. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Sufficiency of Proof.

Where at the time buyer purchased a tractor he also purchased a plow and a disc and the seller informed buyer at the time of sale that the tractor had

sufficient horsepower to pull the plow, the disc, and also a 24-foot preplant applicator, and where seller knew that the tractor and the equipment were purchased for use in custom farming business, the plaintiffs adequately established that the seller had reason to know at the time of contracting that if the tractor were defective the plaintiffs would suffer consequential losses. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Wrongful Rejection of Goods.

Contractor was not entitled to reimbursement for expenses in returning floor drain grating for a swimming pool complex to the wholesaler where the grating substantially conformed to contractor's specifications, making the repudiation of the grating for alleged breach of implied warranty of merchantability invalid. Consolidated Supply Co. v. Babbitt, 96 Idaho 636, 534 P.2d 466 (1975).

Cited Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Decisions Under Prior Law

Amount of Damages.

The buyer who seeks to recover damages for breach of warranty must establish the amount of the damages sustained by competent evidence. Nelson v. Intermountain Farmers Equity, 36 Idaho 518, 211 P. 550 (1922).

Official Comment

Prior Uniform Statutory Provisions: Subsection (2) (b) — Sections 69(7) and 70, Uniform Sales Act.

Changes: Rewritten.

Purposes of Changes and New Matter: 1. Subsection (1) is intended to provide reimbursement for the buyer who incurs reasonable expenses in connection with the handling of rightfully rejected goods or goods whose acceptance may be justifiably revoked, or in connection with effecting cover where the breach of the contract lies in non-conformity or non-delivery of the goods. The incidental damages listed are not intended to be exhaustive but are merely illustrative of the typical kinds of incidental damage.

2. Subsection (2) operates to allow the buyer, in an appropriate case, any consequential damages which are the result of the seller's breach. The "tacit agreement" test for the recovery of consequential damages is rejected. Although the older rule at common law which made the seller liable for all consequential damages of which he had "reason to know" in advance is followed, the liberality of that rule is modified by refusing to permit recovery unless the buyer could not reasonably have prevented the loss by cover or otherwise. Subparagraph (2) carries forward the provisions of the prior uniform statutory provision as to consequential damages resulting from breach of warranty, but modifies the rule by requiring first that the buyer attempt to minimize his damages in good faith, either by cover or otherwise.

3. In the absence of excuse under the section on merchant's excuse by failure of presupposed conditions, the seller is liable for consequential damages in all cases where he had reason to know of the buyer's general or particular requirements at the time of contracting. It is not necessary that there be a conscious acceptance of an insurer's liability on the seller's part, nor is his obligation for consequential damages limited to cases in which he fails to use due effort in good faith.

Particular needs of the buyer must generally be made known to the seller while general needs must rarely be made known to charge the seller with knowledge.

Any seller who does not wish to take the risk of consequential damages has available the section on contractual limitation of remedy.

4. The burden of proving the extent of loss incurred by way of consequential damage is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances.

5. Subsection (2) (b) states the usual rule as to breach of warranty, allowing recovery for injuries "proximately" resulting from the breach. Where the injury involved follows the use of goods without discovery of the defect causing the damage, the question of "proximate" cause turns on whether it was reasonable for the buyer to use the goods without such inspection as would have revealed the defects. If it was not reasonable for

him to do so, or if he did in fact discover the defect prior to his use, the injury would not proximately result from the breach of warranty.

6. In the case of sale of wares to one in the business of reselling them, resale is one of the requirements of which the seller has reason to know within the meaning of subsection (2) (a).

Cross References: Point 1: Section 2-608.

Point 3: Sections 1-203, 2-615 and 2-719.

Point 4: Section 1-106.

Definitional Cross References: “Cover.” Section 2-712.

“Goods.” Section 1-201.

“Person.” Section 1-201.

“Receipt” of goods. Section 2-103.

“Seller.” Section 2-103.

§ 28-2-716. Buyer's right to specific performance or claim and delivery.

— (1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right to maintain a claim and delivery action for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under reservation and satisfaction of the security interest in them has been made or tendered. In the case of goods bought for personal, family or household purposes, the buyer's right of replevin vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

History.

1967, ch. 161, § 2-716, p. 351; am. 2001, ch. 208, § 9, p. 704.

STATUTORY NOTES

Compiler's Notes.

The words "right to maintain a claim and delivery action" near the beginning of subsection (3) were substituted for "right of replevin" in variance from the model Uniform Commercial Code. See also paragraph 3 of the Official Comment.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

CASE NOTES

Conditions Precedent Requirement.

Lower court had authority to order interim payments be made by tenant/alleged purchaser to landlord/alleged vendor during pendency of the action because landlord/alleged vendor's willingness to accept payments until conclusion of action satisfied requirement of specific performance that all conditions precedent to the other party's duty to perform had been satisfied. Hinkle v. Winey, 126 Idaho 993, 895 P.2d 594 (Ct. App. 1995).

Specific Performance Unwarranted.

Where the prospective buyer of a pickup truck had alleged nothing making it unique, nor was it possible for the dealer to sell such a truck since he himself had no such truck, the trial court was correct in denying specific performance. Paloukos v. Intermountain Chevrolet Co., 99 Idaho 740, 588 P.2d 939 (1978).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 1046 et seq.

Official Comment

Prior Uniform Statutory Provision: Section 68, Uniform Sales Act.

Changes: Rephrased.

Purposes of Changes: To make it clear that: 1. The present section continues in general prior policy as to specific performance and injunction against breach. However, without intending to impair in any way the exercise of the court's sound discretion in the matter, this Article [Chapter] seeks to further a more liberal attitude than some courts have shown in connection with the specific performance of contracts of sale.

2. In view of this Article's [Chapter's] emphasis on the commercial feasibility of replacement, a new concept of what are "unique" goods is introduced under this section. Specific performance is no longer limited to goods which are already specific or ascertained at the time of contracting. The test of uniqueness under this section must be made in terms of the total situation which characterizes the contract. Output and requirements contracts involving a particular or peculiarly available source or market

present today the typical commercial specific performance situation, as contrasted with contracts for the sale of heirlooms or priceless works of art which were usually involved in the older cases. However, uniqueness is not the sole basis of the remedy under this section for the relief may also be granted "in other proper circumstances" and inability to cover is strong evidence of "other proper circumstances."

3. The legal remedy of replevin is given to the buyer in cases in which cover is reasonably unavailable and goods have been identified to the contract. This is in addition to the buyer's right to recover identified goods under Section 2-502. For consumer goods, the buyer's right to replevin vests upon the buyer's acquisition of a special property, which occurs upon identification of the goods to the contract. See Section 2-501. Inasmuch as a secured party normally acquires no greater rights in its collateral that its debtor had or had power to convey, see Section 2-403(1) (first sentence), a buyer who acquires a right of replevin under subsection (3) will take free of a security interest created by the seller if it attaches to the goods after the goods have been identified to the contract. The buyer will take free, even if the buyer does not buy in ordinary course and even if the security interest is perfected. Of course, to the extent that the buyer pays the price after the security interest attaches, the payments will constitute proceeds of the security interest.

4. This section is intended to give the buyer rights to the goods comparable to the seller's rights to the price.

5. If a negotiable document of title is outstanding, the buyer's right of replevin relates of course to the document not directly to the goods. See Article [Chapter] 7, especially Section 7-602.

Cross References: Point 3: Section 2-502.

Point 4: Section 2-709.

Point 5: Article [Chapter] 7.

Definitional Cross References: "Buyer." Section 2-103.

"Goods." Section 1-201.

"Rights." Section 1-201.

§ 28-2-717. Deduction of damages from the price. — The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.

History.

1967, ch. 161, § 2-717, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 1122.

Official Comment

Prior Uniform Statutory Provision: See Section 69(1) (a), Uniform Sales Act.

Purposes: 1. This section permits the buyer to deduct from the price damages resulting from any breach by the seller and does not limit the relief to cases of breach of warranty as did the prior uniform statutory provision. To bring this provision into application the breach involved must be of the same contract under which the price in question is claimed to have been earned.

2. The buyer, however, must give notice of his intention to withhold all or part of the price if he wishes to avoid a default within the meaning of the section on insecurity and right to assurances. In conformity with the general policies of this Article [Chapter], no formality of notice is required and any language which reasonably indicates the buyer's reason for holding up his payment is sufficient.

Cross Reference: Point 2: Section 2-609.

Definitional Cross References: "Buyer." Section 2-103.

"Notifies." Section 1-201.

§ 28-2-718. Liquidation or limitation of damages — Deposits. — (1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

(2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds (a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or (b) in the absence of such terms, twenty per cent (20%) of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller.

(3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes (a) a right to recover damages under the provisions of this chapter other than subsection (1), and (b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.

(4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this chapter on resale by an aggrieved seller (section 28-2-706[, Idaho Code]).

History.

1967, ch. 161, § 2-718, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in subsection (4) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Cited Rangen, Inc. v. Valley Trout Farms, Inc., 104 Idaho 284, 658 P.2d 955 (1983).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales § 823 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. Under subsection (1) liquidated damage clauses are allowed where the amount involved is reasonable in the light of the circumstances of the case. The subsection sets forth explicitly the elements to be considered in determining the reasonableness of a liquidated damage clause. A term fixing unreasonably large liquidated damages is expressly made void as a penalty. An unreasonably small amount would be subject to similar criticism and might be stricken under the section on unconscionable contracts or clauses.

2. Subsection (2) refuses to recognize a forfeiture unless the amount of the payment so forfeited represents a reasonable liquidation of damages as determined under subsection (1). A special exception is made in the case of small amounts (20% of the price or $500, whichever is smaller) deposited as security. No distinction is made between cases in which the payment is to be applied on the price and those in which it is intended as security for performance. Subsection (2) is applicable to any deposit or down or part payment. In the case of a deposit or turn in of goods resold before the breach, the amount actually received on the resale is to be viewed as the deposit rather than the amount allowed the buyer for the trade in. However, if the seller knows of the breach prior to the resale of the goods turned in, he must make reasonable efforts to realize their true value, and this is

assured by requiring him to comply with the conditions laid down in the section on resale by an aggrieved seller.

Cross References: Point 1: Section 2-302.

Point 2: Section 2-706.

Definitional Cross References: "Aggrieved party." Section 1-201.

"Agreement." Section 1-201.

"Buyer." Section 2-103.

"Goods." Section 2-105.

"Notice." Section 1-201.

"Party." Section 1-201.

"Remedy." Section 1-201.

"Seller." Section 2-103.

"Term." Section 1-201.

§ 28-2-719. Contractual modification or limitation of remedy. — (1) Subject to the provisions of subsections (2) and (3) of this section and of the preceding section on liquidation and limitation of damages,

(a) the agreement may provide for remedies in addition to or in substitution for those provided in this chapter and may limit or alter the measure of damages recoverable under this chapter, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and (b) resort to a remedy as provided is optional unless the remedy is expressly agreed to be exclusive, in which case it is the sole remedy.

(2) Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this act.

(3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not.

History.

1967, ch. 161, § 2-719, p. 351.

STATUTORY NOTES

Compiler's Notes.

The words "this act" at the end of subsection (2) refer to S. L. 1967, ch. 161, which is generally compiled as chs. 1 to 10 of this title. The reference probably should be to the Uniform Commercial Code.

CASE NOTES

Failure of limited remedy.

No exclusivity language.

Remedy not limited.

Unconscionability.

Application.

This section does not specifically require the plaintiff to prove negligent or willful dilatory conduct; rather, the section is to apply whenever an exclusive remedy, which may have appeared fair and reasonable at the inception of the contract, as a result of later circumstances operates to deprive a party of a substantial benefit of the bargain. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Where the defendants had expressly warranted that the tractor the plaintiff bought was free from defects in material and workmanship under normal use and service, but limited liability to repair or replacement of parts, the intent of the warranty was clear and plaintiff purchaser's remedy was limited to repair or replacement of defective parts. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Disclaimer Effective.

Where the parties were two large corporations of relatively equal bargaining strength, and the disclaimer provisions were discussed by the parties and clearly limited the seller's tort liability, the disclaimer of tort liability in the offer was an effective defense to the buyer's strict liability action. Idaho Power Co. v. Westinghouse Elec. Corp., 596 F.2d 924 (9th Cir. 1979).

Factual Questions Precluding Summary Judgment.

In the situation where farmer bought certified potato seed from dealer and seed was later found to be infected by bacterial ring rot, because factual questions remained as to whether there were any terms in the parties' agreement excluding warranties or limiting remedies and as to whether there was an applicable course of dealing or trade usage limiting remedies, the lower court's order denying summary judgment on this issue was affirmed. Duffin v. Idaho Crop Imp. Ass'n, 126 Idaho 1002, 895 P.2d 1195 (1995).

Failure of Limited Remedy.

The purpose of an exclusive repair or replacement remedy is to ensure that the purchaser receives a product which conforms to the express warranty, i.e., that the product is free from defects, and if the product proves defective within the warranty period the seller is obligated to cure the defect within a reasonable time, but if the seller is subsequently unable or unwilling to repair or replace a defective part within a reasonable time, the buyer is left with a defective product — not conforming to the warranty — and the limited remedy has not achieved its purpose and in such circumstances subsection (2) of this section permits the buyer to pursue the other remedies provided by the Uniform Commercial Code, if the defect substantially affects the value of the buyer's bargain. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

The Uniform Commercial Code is ambiguous with respect to the effect that a failure of a limited remedy under subsection (2) of this section has on other contractual provisions. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

Where various elements of a "New Equipment Warranty" — the express warranty, the limited repair or replacement remedy, the disclaimer of other warranties, and the exclusion of liability for consequential damages — were all integral parts of the provision, reciprocal to one another, and together represented the agreed allocation of risk between the parties, a seller who failed to comply with its obligations under the warranty, such as its repair or replacement duties, could not receive the benefit of the other provisions, which in part at least were premised on the assumption that the seller would fulfill its obligations; the failure of the limited remedy would materially alter the balance of risk set by the parties in the agreement, and, accordingly, other limitations and exclusions on the seller's warranties and liability must be disregarded and the general provisions of the Uniform Commercial Code should govern the rights of the parties. Clark v. International Harvester Co., 99 Idaho 326, 581 P.2d 784 (1978).

No Exclusivity Language.

Where the contract for the supplying and installing of the secondary treatment equipment of the city's sewage treatment plant stated that if performance was not satisfactory, the equipment manufacturer would

remove his equipment and refund the cost of the equipment and its installation at the option of the owner, the contract contained no language of exclusivity, and the city was not limited to an exclusive contract remedy. United States v. City of Twin Falls, 806 F.2d 862 (9th Cir. 1986), cert. denied, 482 U.S. 914, 107 S. Ct. 3185, 96 L. Ed. 2d 674 (1987).

Remedy Not Limited.

Where jury under correct instructions could have found that express warranties on mobile home were breached in various particulars, remedy of buyers was not limited by contract language disavowing any liability and stating that the manufacturer's written warranty would apply nor was repair intended to be the exclusive remedy of the buyer; if the contract limitation language was argued as excluding all remedies against the seller, it was unconscionable and if the language was argued as creating a limited remedy of repair, it failed because such was not clearly expressed in the contract. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Although § 28-2-711(1) did not allow purchasers of an allegedly defective motor home with a limited warranty to pursue a refund claim against the manufacturer, a showing of special circumstances under § 28-2-714(2) and this section might allow the purchasers to avoid the general measure of damages. Miller v. Four Winds Int'l Corp., 827 F. Supp. 2d 1175 (D. Idaho 2011).

Unconscionability.

It is generally unconscionable for a seller to seek to exclude himself from all liabilities. Jensen v. Seigel Mobile Homes Group, 105 Idaho 189, 668 P.2d 65 (1983).

Cited Adkison Corp. v. American Bldg. Co., 107 Idaho 406, 690 P.2d 341 (1984); Potlatch Corp. v. Beloit Corp., 132 Idaho 712, 979 P.2d 114 (1999).

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 830 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: 1. Under this section parties are left free to shape their remedies to their particular requirements and reasonable agreements limiting or modifying remedies are to be given effect.

However, it is of the very essence of a sales contract that at least minimum adequate remedies be available. If the parties intend to conclude a contract for sale within this Article [Chapter] they must accept the legal consequence that there be at least a fair quantum of remedy for breach of the obligations or duties outlined in the contract. Thus any clause purporting to modify or limit the remedial provisions of this Article [Chapter] in an unconscionable manner is subject to deletion and in that event the remedies made available by this Article [Chapter] are applicable as if the stricken clause had never existed. Similarly, under subsection (2), where an apparently fair and reasonable clause because of circumstances fails in its purpose or operates to deprive either party of the substantial value of the bargain, it must give way to the general remedy provisions of this Article [Chapter].

2. Subsection (1) (b) creates a presumption that clauses prescribing remedies are cumulative rather than exclusive. If the parties intend the term to describe the sole remedy under the contract, this must be clearly expressed.

3. Subsection (3) recognizes the validity of clauses limiting or excluding consequential damages but makes it clear that they may not operate in an unconscionable manner. Actually such terms are merely an allocation of unknown or undeterminable risks. The seller in all cases is free to disclaim warranties in the manner provided in Section 2-316.

Cross References: Point 1: Section 2-302.

Point 3: Section 2-316.

Definitional Cross References: "Agreement." Section 1-201.

"Buyer." Section 2-103.

"Conforming." Section 2-106.

"Contract." Section 1-201.

"Goods." Section 2-105.

"Remedy." Section 1-201.

"Seller." Section 2-103.

§ 28-2-720. Effect of "cancellation" or "rescission" on claims for antecedent breach. — Unless the contrary intention clearly appears, expressions of "cancellation" or "rescission" of the contract or the like shall not be construed as a renunciation or discharge of any claim in damages for an antecedent breach.

History.

1967, ch. 161, § 2-720, p. 351.

CASE NOTES

Intent.

A buyer's failure to object to the seller's repudiation of a contract for the sale of a truck did not constitute a rescission of the contract or a waiver of his claims for damages, because a rescission was not clearly intended by the buyer and the buyer was free to proceed at any time with his optional remedies. Palmer v. Idaho Peterbilt, Inc., 102 Idaho 800, 641 P.2d 346 (Ct. App. 1982).

Official Comment Prior Uniform Statutory Provision: None.

Purpose: This section is designed to safeguard a person holding a right of action from any unintentional loss of rights by the ill-advised use of such terms as "cancellation," "rescission," or the like. Once a party's rights have accrued they are not to be lightly impaired by concessions made in business decency and without intention to forgo them. Therefore, unless the cancellation of a contract expressly declares that it is "without reservation of rights," or the like, it cannot be considered to be a renunciation under this section.

Cross Reference: Section 1-107.

Definitional Cross References: "Cancellation." Section 2-106.

"Contract." Section 1-201.

§ 28-2-721. Remedies for fraud. — Remedies for material misrepresentation or fraud include all remedies available under this chapter for nonfraudulent breach. Neither rescission or a claim for rescission of the contract for sale nor rejection or return of the goods shall bar or be deemed inconsistent with a claim for damages or other remedy.

History.

1967, ch. 161, § 2-721, p. 351.

CASE NOTES

Applicability.

Buyer could not recover damages from a debtor's partners under this section because the partners made no representations to the buyer, nor could they have breached the sales contract because the partners were not parties to the contract. In re Morton, 2009 Bankr. LEXIS 1518 (Bankr. D. Idaho June 9, 2009).

Cited Tusch Enters. v. Coffin, 113 Idaho 37, 740 P.2d 1022 (1987).

Official Comment Prior Uniform Statutory Provision: None.

Purposes: To correct the situation by which remedies for fraud have been more circumscribed than the more modern and mercantile remedies for breach of warranty. Thus the remedies for fraud are extended by this section to coincide in scope with those for nonfraudulent breach. This section thus makes it clear that neither rescission of the contract for fraud nor rejection of the goods bars other remedies unless the circumstances of the case make the remedies incompatible.

Definitional Cross References: "Contract for sale." Section 2-106.

"Goods." Section 1-201.

"Remedy." Section 1-201.

§ 28-2-722. Who can sue third parties for injury to goods. — Where a third party so deals with goods which have been identified to a contract for sale as to cause actionable injury to a party to that contract

(a) a right of action against the third party is in either party to the contract for sale who has title to or a security interest or a special property or an insurable interest in the goods; and if the goods have been destroyed or converted a right of action is also in the party who either bore the risk of loss under the contract for sale or has since the injury assumed that risk as against the other; (b) if at the time of the injury the party plaintiff did not bear the risk of loss as against the other party to the contract for sale and there is no arrangement between them for disposition of the recovery, his suit or settlement is, subject to his own interest, as a fiduciary for the other party to the contract; (c) either party may with the consent of the other sue for the benefit of whom it may concern.

History.

1967, ch. 161, § 2-722, p. 351.

CASE NOTES

Subsequent Purchaser.

Where it was clear that subsequent purchaser did not interfere with the contract between original purchaser and the sellers in any fashion or indeed that he had any knowledge of such contract, the sellers could not maintain an action against the subsequent purchaser. Western Idaho Prod. Credit Ass'n v. Simplot Feed Lots, Inc., 106 Idaho 264, 678 P.2d 52 (1984).

RESEARCH REFERENCES

Am. Jur. 2d. — 67 Am. Jur. 2d, Sales, § 377.

68A Am. Jur. 2d, Secured Transactions, §§ 100, 101.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: To adopt and extend somewhat the principle of the statutes which provide for suit by the real party in interest. The provisions of this section apply only after identification of the goods. Prior to that time only the seller has a right of action. During the period between identification and final acceptance (except in the case of revocation of acceptance) it is possible for both parties to have the right of action. Even after final acceptance both parties may have the right of action if the seller retains possession or otherwise retains an interest.

Definitional Cross References: "Action." Section 1-201.

"Buyer." Section 2-103.

"Contract for sale." Section 2-106.

"Goods." Section 2-105.

"Party." Section 1-201.

"Rights." Section 1-201.

"Security interest." Section 1-201.

§ 28-2-723. Proof of market price — Time and place. — (1) If an action based on anticipatory repudiation comes to trial before the time for performance with respect to some or all of the goods, any damages based on market price (section 28-2-708[, Idaho Code] or section 28-2-713[, Idaho Code]) shall be determined according to the price of such goods prevailing at the time when the aggrieved party learned of the repudiation.

(2) If evidence of a price prevailing at the times or places described in this chapter is not readily available the price prevailing within any reasonable time before or after the time described or at any other place which in commercial judgment or under usage of trade would serve as a reasonable substitute for the one described may be used, making any proper allowance for the cost of transporting the goods to or from such other place.

(3) Evidence of a relevant price prevailing at a time or place other than the one described in this chapter offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise.

History.

1967, ch. 161, § 2-723, p. 351.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (1) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted
RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 819 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: To eliminate the most obvious difficulties arising in connection with the determination of market price, when that is stipulated as a measure of damages by some provision of this Article [Chapter]. Where the appropriate market price is not readily available the court is here granted reasonable leeway in receiving evidence of prices current in other comparable markets or at other times comparable to the one in question. In accordance with the general principle of this Article [Chapter] against surprise, however, a party intending to offer evidence of such a substitute price must give suitable notice to the other party.

This section is not intended to exclude the use of any other reasonable method of determining market price or of measuring damages if the circumstances of the case make this necessary.

Definitional Cross References: "Action." Section 1-201.

"Aggrieved party." Section 1-201.

"Goods." Section 2-105.

"Notifies." Section 1-201.

"Party." Section 1-201.

"Reasonable time." Section 1-204 [1-205].

"Usage of trade." Section 1-205 [1-303].

§ 28-2-724. Admissibility of market quotations. — Whenever the prevailing price or value of any goods regularly bought and sold in any established commodity market is in issue, reports in official publications or trade journals or in newspapers or periodicals of general circulation published as the reports of such market shall be admissible in evidence. The circumstances of the preparation of such a report may be shown to affect its weight but not its admissibility.

History.

1967, ch. 161, § 2-724, p. 351.

RESEARCH REFERENCES

Am. Jur. 2d. — 67A Am. Jur. 2d, Sales, § 819 et seq.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: To make market quotations admissible in evidence while providing for a challenge of the material by showing the circumstances of its preparation.

No explicit provision as to the weight to be given to market quotations is contained in this section, but such quotations, in the absence of compelling challenge, offer an adequate basis for a verdict.

Market quotations are made admissible when the price or value of goods traded "in any established market" is in issue. The reason of the section does not require that the market be closely organized in the manner of a produce exchange. It is sufficient if transactions in the commodity are frequent and open enough to make a market established by usage in which one price can be expected to affect another and in which an informed report of the range and trend of prices can be assumed to be reasonably accurate.

This section does not in any way intend to limit or negate the application of similar rules of admissibility to other material, whether by action of the courts or by statute. The purpose of the present section is to assure a

minimum of mercantile administration in this important situation and not to limit any liberalizing trend in modern law.

Definitional Cross Reference: "Goods." Section 2-105.

§ 28-2-725. Statute of limitations in contracts for sale. — (1) An action for breach of any contract for sale must be commenced within four (4) years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one (1) year but may not extend it.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

(3) Where an action commenced within the time limited by subsection (1) is so terminated as to leave available a remedy by another action for the same breach such other action may be commenced after the expiration of the time limited and within six (6) months after the termination of the first action unless the termination resulted from voluntary discontinuance or from dismissal for failure or neglect to prosecute.

(4) This section does not alter the law on tolling of the statute of limitations nor does it apply to causes of action which have accrued before this act becomes effective.

History.

1967, ch. 161, § 2-725, p. 351.

STATUTORY NOTES

Compiler's Notes.

The words "this act" in subsection (4) refer to S. L. 1967, ch. 161, which was effective December 31, 1967.

CASE NOTES

Accrual of cause of action.

Accrual of Cause of Action.

In a breach of warranty case where damages are a measure of cost of replacement, prejudgment interest should accrue from the date that the product's failure required that the product be replaced. Meldco, Inc. v. Hollytex Carpet Mills, Inc., 118 Idaho 265, 796 P.2d 142 (Ct. App. 1990).

Although an action for breach of warranty accrues at the time of delivery, that date does not necessarily govern the accrual date for an award of prejudgment interest; rather, an award of prejudgment interest, in order to fulfill its compensatory purpose, should run from the date the damages amount first becomes "fixed" or "ascertainable." Meldco, Inc. v. Hollytex Carpet Mills, Inc., 118 Idaho 265, 796 P.2d 142 (Ct. App. 1990).

Seller of insulation was not entitled to summary judgment against a buyer who alleged that the seller's manufacturing process caused the insulation to shrink after installation. Because it was unclear when the shrinkage, which was hidden after installation, should have been discovered, the court could not rule as a matter of law that the buyer's warranty claims were time-barred. Hansen-Rice, Inc. v. Celotex Corp., 414 F. Supp. 2d 970 (D. Idaho 2006).

Contract for Sale of Goods.

The language of this section indicates a legislative intent that all actions for breach of contract for the sale of goods are controlled by this section. Farmers Nat'l Bank v. Wickham Pipeline Constr., 114 Idaho 565, 759 P.2d 71 (1988).

The limitations provisions of this section applied to action for the sale of pipe which was movable and clearly constituted goods; where the last pipe was delivered on October 25, 1979, but the action was not filed until September 17, 1984, the action was barred at the time of filing. Farmers Nat'l Bank v. Wickham Pipeline Constr., 114 Idaho 565, 759 P.2d 71 (1988).

The absolute language of this section indicates a legislative intent that all actions based on breach of contract for the sale of goods be brought, if at all, within four years of the delivery of the goods; this interpretation is further supported by the statutory provision prohibiting the parties from extending the limitation period by agreement. Farmers Nat'l Bank v. Wickham Pipeline Constr., 114 Idaho 565, 759 P.2d 71 (1988).

This section and not § 5-216 controls all actions for breach of contract for the sale of goods, for § 28-2-102 provides that, unless the context otherwise requires, Chapter 2 applies to transactions in goods. Farmers Nat'l Bank v. Wickham Pipeline Constr., 114 Idaho 565, 759 P.2d 71 (1988).

Where contractor and surety had a contract with supplier of pipe and if supplier did not deliver pipe meeting the specifications of the contract, a breach of contract action accrued and, upon delivery of the deficient pipe, contractor and surety had a direct legal cause of action against supplier; however, such parties could not maintain an equitable action for indemnification against the supplier after their legal claim for breach had been barred by limitations. Farmers Nat'l Bank v. Wickham Pipeline Constr., 114 Idaho 565, 759 P.2d 71 (1988).

In General.

Where a truck was leased in 1969 and damaged in a collision on March 16, 1971, insured lessee's breach of warranty action against the seller and the manufacturer was extinguished in 1973, and the insurer's claim by subrogation was likewise barred since the subrogee had no greater rights and was subject to the same statute of limitations. May Trucking Co. v. International Harvester Co., 97 Idaho 319, 543 P.2d 1159 (1975).

Latent Defects.

Subsection (2) provides that, where a warranty explicitly extends to future performance of goods, any breach of warranty occurs at the time of such performance. Thus, while a buyer has a duty to inspect goods at the time of delivery to find patent defects, he must be allowed a reasonable time after inspecting and accepting the goods to discover latent defects under this section. Where farmers alleged a breach of warranty due to a latent defect in feed supplement supplier's product — its propensity to turn acidic and, thus, be harmful to calves if not refrigerated — the defect could not have

been found on inspection at delivery. Millenkamp v. Davisco Foods Int'l, Inc., 562 F.3d 971 (9th Cir. 2009).

Warranties.

Where any warranties of merchantability were made between the defendant manufacturer and the purchaser, the plaintiff, as a seasonal employee of the purchaser, was a person to whom the warranties were extended, and the trial court properly granted defendants' motion for summary judgment as to plaintiff's warranty claim, filed 17 years after delivery. Puckett v. Oakfabco, Inc., 132 Idaho 816, 979 P.2d 1174 (1999).

Cited Salmon Rivers Sportsman Camps, Inc. v. Cessna Aircraft Co., 97 Idaho 348, 544 P.2d 306 (1975).

RESEARCH REFERENCES

Am. Jur. 2d. — 68A Am. Jur. 2d, Secured Transactions, § 648.

ALR. — Statute permitting new action after failure of original action commenced within period of limitation, as applicable in cases where original action failed for lack of jurisdiction. 6 A.L.R.3d 1043.

Validity of contractual time period, shorter than statute of limitations, for bringing action. 6 A.L.R.3d 1197.

Applicability, as affected by change in parties, of statute permitting commencement of new action within specified time after failure of prior action not on merits. 13 A.L.R.3d 848.

Effect of statute permitting new action to be brought within specified period after failure of original action other than on the merits to limit period of limitations. 13 A.L.R.3d 979.

Power of court to make or permit amendment of indictment with respect to allegations as to time. 14 A.L.R.3d 1297.

Application to period of limitations fixed by contract, of statute permitting new action to be brought within specified time after failure of prior action for cause other than on the merits. 16 A.L.R.3d 452.

Agreement of parties as estopping reliance on statute of limitations. 43 A.L.R.3d 756.

Promises to settle or perform as estopping reliance on statute of limitations. 44 A.L.R.3d 482.

Plaintiff's diligence as affecting his right to have defendant estopped from pleading the statute of limitations. 44 A.L.R.3d 760.

Fiduciary or confidential relationship of affecting estoppel to plead statute of limitations. 45 A.L.R.3d 630.

Delay caused by other litigation as estopping reliance on statute of limitations. 45 A.L.R.3d 703.

Tolling of statute of limitations during absence from state as affected by fact that party claimed benefit of limitations remained subject to service during absence or nonresidence. 55 A.L.R.3d 1158.

Imprisonment of party to civil action as tolling statute of limitations. 77 A.L.R.3d 735.

Choice of law as to applicable statute of limitations in contract actions. 78 A.L.R.3d 639.

Validity of contractual provision establishing period of limitations longer than that provided by state statute of limitations. 84 A.L.R.3d 1172.

Relation back of amended pleading substituting true name of defendant for fictitious name used in earlier pleading so as to avoid bar of limitations. 85 A.L.R.3d 130.

What constitutes warranty explicitly extending to "future performance" for purposes of UCC § 2-725(2). 93 A.L.R.3d 690.

Statute of limitations as bar to arbitration under agreement. 94 A.L.R.3d 533.

Application to actions for personal injuries based on breach of implied warranty under provisions governing sales. 20 A.L.R.4th 915.

What constitutes warranty explicitly extending to "future performance" for purposes of UCC § 2-725(2). 81 A.L.R.5th 483.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Goods and Services: Distributorship, Franchise, and Similar Business Contracts. 8 A.L.R.7th 4.

Applicability of UCC Article 2 to Mixed Contracts for Sale of Business Goods and Services: Manufacturing, Construction, and Similar Contracts. 15 A.L.R.7th 7.

Official Comment

Prior Uniform Statutory Provision: None.

Purposes: To introduce a uniform statute of limitations for sales contracts, thus eliminating the jurisdictional variations and providing needed relief for concerns doing business on a nationwide scale whose contracts have heretofore been governed by several different periods of limitation depending upon the state in which the transaction occurred. This Article [Chapter] takes sales contracts out of the general laws limiting the time for commencing contractual actions and selects a four-year period as the most appropriate to modern business practice. This is within the normal commercial record keeping period.

Subsection (1) permits the parties to reduce the period of limitation. The minimum period is set at one year. The parties may not, however, extend the statutory period.

Subsection (2), providing that the cause of action accrues when the breach occurs, states an exception where the warranty extends to future performance.

Subsection (3) states the saving provision included in many state statutes and permits an additional short period for bringing new actions, where suits begun within the four-year period have been terminated so as to leave a remedy still available for the same breach.

Subsection (4) makes it clear that this Article [Chapter] does not purport to alter or modify in any respect the law on tolling of the Statute of Limitations as it now prevails in the various jurisdictions.

Definitional Cross References: “Action.” Section 1-201.

“Aggrieved party.” Section 1-201.

“Agreement.” Section 1-201.

“Contract for sale.” Section 2-106.

"Goods." Section 2-105.

"Party." Section 1-201.

"Remedy." Section 1-201.

"Term." Section 1-201.

"Termination." Section 2-106.

Chapter 3
UNIFORM COMMERCIAL CODE — NEGOTIABLE INSTRUMENTS

Part 1. General Provisions and Definitions

Sec.

Part 2. Negotiation, Transfer, And Indorsement

Part 3. Enforcement of Instruments

Part 4. Liability of Parties

Part 5. Dishonor

Part 1
General Provisions and Definitions

Idaho Code § 28-3-101

§ 28-3-101. Short title. — This chapter may be cited as "Uniform Commercial Code — Negotiable Instruments."

History.

I.C., § 28-3-101, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

The following former sections were repealed by S.L. 1993, ch. 288, § 1, effective July 1, 1993:

§ 28-3-101, which comprised 1967, ch. 161, § 3-101, p. 351.

§ 28-3-102, which comprised 1967, ch. 161, § 3-102, p. 351.

§ 28-3-103, which comprised 1967, ch. 161, § 3-103, p. 351.

§ 28-3-104, which comprised 1967, ch. 161, § 3-104, p. 351.

§ 28-3-105, which comprised 1967, ch. 161, § 3-105, p. 351.

§ 28-3-106, which comprised 1967, ch. 161, § 3-106, p. 351.

§ 28-3-107, which comprised 1967, ch. 161, § 3-107, p. 351.

§ 28-3-108, which comprised 1967, ch. 161, § 3-108, p. 351.

§ 28-3-109, which comprised 1967, ch. 161, § 3-109, p. 351.

§ 28-3-110, which comprised 1967, ch. 161, § 3-110, p. 351.

§ 28-3-111, which comprised 1967, ch. 161, § 3-111, p. 351.

§ 28-3-112, which comprised 1967, ch. 161, § 3-112, p. 351.

§ 28-3-113, which comprised 1967, ch. 161, § 3-113, p. 351.

§ 28-3-114, which comprised 1967, ch. 161, § 3-114, p. 351.

§ 28-3-115, which comprised 1967, ch. 161, § 3-115, p. 351.

§ 28-3-116, which comprised 1967, ch. 161, § 3-116, p. 351.

§ 28-3-117, which comprised 1967, ch. 161, § 3-117, p. 351.

§ 28-3-118, which comprised 1967, ch. 161, § 3-118, p. 351.

§ 28-3-119, which comprised 1967, ch. 161, § 3-119, p. 351.

§ 28-3-120, which comprised 1967, ch. 161, § 3-120, p. 351.

§ 28-3-121, which comprised 1967, ch. 161, § 3-121, p. 351.

§ 28-3-122, which comprised 1967, ch. 161, § 3-122, p. 351.

§ 28-3-201, which comprised 1967, ch. 161, § 3-201, p. 351.

§ 28-3-202, which comprised 1967, ch. 161, § 3-202, p. 351.

§ 28-3-203, which comprised 1967, ch. 161, § 3-203, p. 351.

§ 28-3-204, which comprised 1967, ch. 161, § 3-204, p. 351.

§ 28-3-205, which comprised 1967, ch. 161, § 3-205, p. 351.

§ 28-3-206, which comprised 1967, ch. 161, § 3-206, p. 351.

§ 28-3-207, which comprised 1967, ch. 161, § 3-207, p. 351.

§ 28-3-208, which comprised 1967, ch. 161, § 3-208, p. 351.

§ 28-3-301, which comprised 1967, ch. 161, § 3-301, p. 351.

§ 28-3-302, which comprised 1967, ch. 161, § 3-302, p. 351.

§ 28-3-303, which comprised 1967, ch. 161, § 3-303, p. 351.

§ 28-3-304, which comprised 1967, ch. 161, § 3-304, p. 351.

§ 28-3-305, which comprised 1967, ch. 161, § 3-305, p. 351.

§ 28-3-306, which comprised 1967, ch. 161, § 3-306, p. 351.

§ 28-3-307, which comprised 1967, ch. 161, § 3-307, p. 351.

§ 28-3-401, which comprised 1967, ch. 161, § 3-401, p. 351.

§ 28-3-402, which comprised 1967, ch. 161, § 3-402, p. 351.

§ 28-3-403, which comprised 1967, ch. 161, § 3-403, p. 351.

§ 28-3-404, which comprised 1967, ch. 161, § 3-404, p. 351.

§ 28-3-405, which comprised 1967, ch. 161, § 3-405, p. 351.

§ 28-3-406, which comprised 1967, ch. 161, § 3-406, p. 351.

§ 28-3-407, which comprised 1967, ch. 161, § 3-407, p. 351.

§ 28-3-408, which comprised 1967, ch. 161, § 3-408, p. 351.

§ 28-3-409, which comprised 1967, ch. 161, § 3-409, p. 351.

§ 28-3-410, which comprised 1967, ch. 161, § 3-410, p. 351.

§ 28-3-411, which comprised 1967, ch. 161, § 3-411, p. 351.

§ 28-3-412, which comprised 1967, ch. 161, § 3-412, p. 351.

§ 28-3-413, which comprised 1967, ch. 161, § 3-413, p. 351.

§ 28-3-414, which comprised 1967, ch. 161, § 3-414, p. 351.

§ 28-3-415, which comprised 1967, ch. 161, § 3-415, p. 351.

§ 28-3-416, which comprised 1967, ch. 161, § 3-416, p. 351.

§ 28-3-417, which comprised 1967, ch. 161, § 3-417, p. 351.

§ 28-3-418, which comprised 1967, ch. 161, § 3-418, p. 351.

§ 28-3-419, which comprised 1967, ch. 161, § 3-419, p. 351.

§ 28-3-501, which comprised 1967, ch. 161, § 3-501, p. 351.

§ 28-3-502, which comprised 1967, ch. 161, § 3-502, p. 351.

§ 28-3-503, which comprised 1967, ch. 161, § 3-503, p. 351.

§ 28-3-504, which comprised 1967, ch. 161, § 3-504, p. 351.

§ 28-3-505, which comprised 1967, ch. 161, § 3-505, p. 351.

§ 28-3-506, which comprised 1967, ch. 161, § 3-506, p. 351.

§ 28-3-507, which comprised 1967, ch. 161, § 3-507, p. 351.

§ 28-3-508, which comprised 1967, ch. 161, § 3-508, p. 351.

§ 28-3-509, which comprised 1967, ch. 161, § 3-509, p. 351.

§ 28-3-510, which comprised 1967, ch. 161, § 3-510, p. 351.

§ 28-3-510A, which comprised I.C., § 28-3-510A, as added by 1973, ch. 120, § 1, p. 227; am. 1982, ch. 105, § 1, p. 286; am. 1984, ch. 50, § 1, p. 91; am. 1988, ch. 179, § 1, p. 312.

§ 28-3-510B, which comprised I.C., § 28-3-510B, as added by 1973, ch. 120, § 2, p. 227.

§ 28-3-510C, which comprised I.C., § 28-3-510C, as added by 1973, ch. 120, § 3, p. 227; am. 1982, ch. 105, § 2, p. 286; am. 1988, ch. 179, § 2, p. 312.

§ 28-3-511, which comprised 1967, ch. 161, § 3-511, p. 351.

§ 28-3-601, which comprised 1967, ch. 161, § 3-601, p. 351.

§ 28-3-602, which comprised 1967, ch. 161, § 3-602, p. 351.

§ 28-3-603, which comprised 1967, ch. 161, § 3-603, p. 351.

§ 28-3-604, which comprised 1967, ch. 161, § 3-604, p. 351.

§ 28-3-605, which comprised 1967, ch. 161, § 3-605, p. 351.

§ 28-3-606, which comprised 1967, ch. 161, § 3-606, p. 351.

§ 28-3-701, which comprised 1967, ch. 161, § 3-701, p. 351.

§ 28-3-801, which comprised 1967, ch. 161, § 3-801, p. 351.

§ 28-3-802, which comprised 1967, ch. 161, § 3-802, p. 351.

§ 28-3-803, which comprised 1967, ch. 161, § 3-803, p. 351.

§ 28-3-804, which comprised 1967, ch. 161, § 3-804, p. 351.

§ 28-3-805, which comprised 1967, ch. 161, § 3-805, p. 351.

Compiler's Notes.

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Section 1 of S.L. 1993, ch. 288 repealed chapter 3, Title 28 of the Idaho Code.

Section 54 of S.L. 1993, ch. 288 read: "Rights and obligations that arose under Chapter 6, Title 28, Idaho Code, and Section 28-9-111, Idaho Code,

before their repeal remain valid and may be enforced as though those statutes had not been repealed."

Since the Idaho legislature, in enacting Uniform Commercial Code — Leases (S.L. 1993, ch. 288), did not adopt section 3-307 of the uniform version, §§ 28-3-307 to 28-3-111 of the Idaho Code correspond to §§ 3-308 to 3-312 of the uniform version.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 1 et seq.

C.J.S. — 10 C.J.S., Bills and Notes, § 1 et seq.

ALR. — What constitutes, under the Uniform Negotiable Instruments Law or Commercial Code, a reasonable time for taking a demand instrument, so as to support the taker's status as holder in due course. 10 A.L.R.3d 1199.

Construction and effect of UCC Art. 3, dealing with commercial paper. 23 A.L.R.3d 932; 42 A.L.R.5th 137.

Account stated based upon check or note tendered in payment of debt. 46 A.L.R.3d 1325.

Personal liability of officer or directors of corporation on corporate checks issued against insufficient funds. 47 A.L.R.3d 1250.

Discharge of debtor who makes payment by delivering check payable to creditor to latter's agent, where agent forges creditor's signature and absconds with proceeds. 49 A.L.R.3d 843.

Commercial paper: what amounts to "negligence contributing to alteration or unauthorized signature" under UCC § 3-406. 67 A.L.R.3d 144.

Fraud in the inducement and fraud in the factum as defenses under UCC § 3-305 against holder in due course. 78 A.L.R.3d 1020.

What constitutes unconditional promise to pay under UCC § 3-104(1)(b). 88 A.L.R.3d 1100.

Construction and application of UCC § 3-403(2) dealing with personal liability of authorized representative who signs negotiable instrument in his own name. 97 A.L.R.3d 798.

Payee's right of recovery, in conversion under UCC § 3-419(1)(c), for money paid on unauthorized indorsement. 23 A.L.R.4th 855.

Extent of bank's liability for paying postdated check. 31 A.L.R.4th 329.

What constitutes taking instrument in good faith, and without notice of infirmities or defenses, to support holder-in-due-course status, under UCC § 3-302. 36 A.L.R.4th 212.

Creditor's retention without negotiation of check purporting to be final settlement of disputed amount as constituting accord and satisfaction. 42 A.L.R.4th 117.

What constitutes "dealing" under UCC § 3-305(2), providing that holder in due course takes instrument free from all defenses of any party to instrument with whom holder has not dealt. 42 A.L.R.5th 137.

When is instrument issued or transferred for "value" under UCC § 3-303. 77 A.L.R.5th 429.

§ 28-3-102. Subject matter. — (1) This chapter applies to negotiable instruments. It does not apply to money, to payment orders governed by part 6 of chapter 4[, title 28, Idaho Code], or to securities governed by chapter 8[, title 28, Idaho Code].

(2) If there is conflict between this chapter and chapter 4 or 9, chapters 4 and 9[, title 28, Idaho Code,] govern.

(3) Regulations of the board of governors of the federal reserve system and operating circulars of the federal reserve banks supersede any inconsistent provision of this chapter to the extent of the inconsistency.

History.

I.C., § 28-3-102, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-102 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (1) and (2) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Former Article 3 had no provision affirmatively stating its scope. Former Section 3-103 was a limitation on scope. In revised Article 3, Section 3-102 states that Article 3 applies to "negotiable instruments," defined in Section 3-104. Section 3-104(b) also defines the term "instrument" as a synonym for "negotiable instrument." In most places Article 3 uses the shorter term "instrument." This follows the convention used in former Article 3.

2. The reference in former Section 3-103(1) to "documents of title" is omitted as superfluous because these documents contain no promise to pay money. The definition of "payment order" in Section 4A-103(a)(1)(iii)

excludes drafts which are governed by Article 3. Section 3-102(a) makes clear that a payment order governed by Article 4A is not governed by Article 3. Thus, Article 3 and Article 4A are mutually exclusive.

Article 8 states in Section 8-103(d) that "A writing that is a security certificate is governed by this Article and not by Article 3, even though it also meets the requirements of that Article." Section 3-102(a) conforms to this provision. With respect to some promises or orders to pay money, there may be a question whether the promise or order is an instrument under Section 3-104(a) or a certificated security under Section 8-102(a)(4) and (15). Whether a writing is covered by Article 3 or Article 8 has important consequences. Among other things, under Section 8-207, the issuer of a certificated security may treat the registered owner as the owner for all purposes until the presentment for registration of a transfer. The issuer of a negotiable instrument, on the other hand, may discharge its obligation to pay the instrument only by paying a person entitled to enforce under Section 3-301. There are also important consequences to an indorser. An indorser of a security does not undertake the issuer's obligation or make any warranty that the issuer will honor the underlying obligation, while an indorser of a negotiable instrument becomes secondarily liable on the underlying obligation.

Ordinarily the distinction between instruments and certificated securities in non-bearer form should be relatively clear. A certificated security under Article 8 must be in registered form (Section 8-102(a)(13)) so that it can be registered on the issuer's records. By contrast, registration plays no part in Article 3. The distinction between an instrument and a certificated security in bearer form may be somewhat more difficult and will generally lie in the economic functions of the two writings. Ordinarily, negotiable instruments under Article 3 will be separate and distinct instruments, while certificated securities under Article 8 will be either one of a class or series or by their terms divisible into a class or series (Section 8-102(a)(15)(ii)). Thus, a promissory note in bearer form could come under either Article 3 if it were simply an individual note, or under Article 8 if it were one of a series of notes or divisible into a series. An additional distinction is whether the instrument is of the type commonly dealt in on securities exchanges or markets or commonly recognized as a medium for investment (Section 8-102(a)(15)(iii)). Thus, a check written in bearer form (i.e., a check made

payable to “cash”) would not be a certificated security within Article 8 of the Uniform Commercial Code.

Occasionally, a particular writing may fit the definition of both a negotiable instrument under Article 3 and of an investment security under Article 8. In such cases, the instrument is subject exclusively to the requirements of Article 8. Section 8-102(1)(c) and Section 8-103(d).

3. Although the terms of Article 3 apply to transactions by Federal Reserve Banks, federal preemption would make ineffective any Article 3 provision that conflicts with federal law. The activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 3-102(c) states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 3 to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. *Childs v. Federal Reserve Bank of Dallas,* 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 3-102(c) treats operating circulars as having the same effect whether issued under the Reserve Bank’s own authority or under a Federal Reserve Board regulation. Federal statutes may also preempt Article 3. For example, the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., provides that the Act and the regulations issued pursuant to the Act supersede any inconsistent provisions of the UCC. 12 U.S.C. § 4007(b).

4. In *Clearfield Trust Co. v. United States,* 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In *United States v. Kimbell Foods, Inc.,* 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the *Kimbell* test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In *Kimbell* the Court adopted the priorities rules of Article 9.

5. In 1989 the United Nations Commission on International Trade Law completed a Convention on International Bills of Exchange and International Promissory Notes. If the United States becomes a party to this Convention, the Convention will preempt state law with respect to international bills and notes governed by the Convention. Thus, an international bill of exchange or promissory note that meets the definition of instrument in Section 3-104 will not be governed by Article 3 if it is governed by the Convention. That Convention applies only to bills and notes that indicate on their face that they involve cross-border transactions. It does not apply at all to checks. Convention Articles 1(3), 2(1), 2(2). Moreover, because it applies only if the bill or note specifically calls for application of the Convention, Convention Article 1, there is little chance that the Convention will apply accidentally to a transaction that the parties intended to be governed by this Article.

§ 28-3-103. Definitions. — (1) In this chapter:

(a) "Acceptor" means a drawee who has accepted a draft.

(b) "Drawee" means a person ordered in a draft to make payment.

(c) "Drawer" means a person who signs or is identified in a draft as a person ordering payment.

(d) "Good faith" means honesty in fact in the conduct or transaction concerned.

(e) "Maker" means a person who signs or is identified in a note as a person undertaking to pay.

(f) "Order" means a written instruction to pay money signed by the person giving the instruction. The instruction may be addressed to any person, including the person giving the instruction, or to one (1) or more persons jointly or in the alternative but not in succession. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay.

(g) "Ordinary care" in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged. In the case of a bank that takes an instrument for processing for collection or payment by automated means, reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproved by this chapter or chapter 4[, title 28, Idaho Code].

(h) "Party" means a party to an instrument.

(i) "Promise" means a written undertaking to pay money signed by the person undertaking to pay. An acknowledgment of an obligation by the obligor is not a promise unless the obligor also undertakes to pay the obligation.

(j) “Prove” with respect to a fact means to meet the burden of establishing the fact (section 28-1-201(b)(8)[, Idaho Code]).

(k) “Remitter” means a person who purchases an instrument from its issuer if the instrument is payable to an identified person other than the purchaser.

(2) Other definitions applying to this chapter and the sections in which they appear are: “Acceptance” Section 28-3-409[, Idaho Code]

“Accommodated party” Section 28-3-419[, Idaho Code]

“Accommodation party” Section 28-3-419[, Idaho Code]

“Alteration” Section 28-3-407[, Idaho Code]

“Anomalous indorsement” Section 28-3-205[, Idaho Code]

“Blank indorsement” Section 28-3-205[, Idaho Code]

“Cashier’s check” Section 28-3-104[, Idaho Code]

“Certificate of deposit” Section 28-3-104[, Idaho Code]

“Certified check” Section 28-3-409[, Idaho Code]

“Check” Section 28-3-104[, Idaho Code]

“Consideration” Section 28-3-303[, Idaho Code]

“Demand draft” Section 28-3-104[, Idaho Code]

“Draft” Section 28-3-104[, Idaho Code]

“Holder in due course” Section 28-3-302[, Idaho Code]

“Incomplete instrument” Section 28-3-115[, Idaho Code]

“Indorsement” Section 28-3-204[, Idaho Code]

“Indorser” Section 28-3-204[, Idaho Code]

“Instrument” Section 28-3-104[, Idaho Code]

“Issue” Section 28-3-105[, Idaho Code]

“Issuer” Section 28-3-105[, Idaho Code]

“Negotiable instrument” Section 28-3-104[, Idaho Code]

“Negotiation” Section 28-3-201[, Idaho Code]

“Note” Section 28-3-104[, Idaho Code]

“Payable at a definite time” Section 28-3-108[, Idaho Code]

“Payable on demand” Section 28-3-108[, Idaho Code]

“Payable to bearer” Section 28-3-109[, Idaho Code]

“Payable to order” Section 28-3-109[, Idaho Code]

“Payment” Section 28-3-602[, Idaho Code]

“Person entitled to enforce” Section 28-3-301[, Idaho Code]

“Presentment” Section 28-3-501[, Idaho Code]

“Reacquisition” Section 28-3-207[, Idaho Code]

“Special indorsement” Section 28-3-205[, Idaho Code]

“Teller’s check” Section 28-3-104[, Idaho Code]

“Transfer of instrument” Section 28-3-203[, Idaho Code]

“Traveler’s check” Section 28-3-104[, Idaho Code]

“Value” Section 28-3-303[, Idaho Code]

(3) The following definitions in other chapters apply to this chapter: “Bank” Section 28-4-105[, Idaho Code]

“Banking day” Section 28-4-104[, Idaho Code]

“Clearing house” Section 28-4-104[, Idaho Code]

“Collecting bank” Section 28-4-105[, Idaho Code]

“Depositary bank” Section 28-4-105[, Idaho Code]

“Documentary draft” Section 28-4-104[, Idaho Code]

“Intermediary bank” Section 28-4-105[, Idaho Code]

“Item” Section 28-4-104[, Idaho Code]

“Payor bank” Section 28-4-105[, Idaho Code]

“Suspends payments” Section 28-4-104[, Idaho Code]

(4) In addition, chapter 1[, title 28, Idaho Code,] contains general definitions and principles of construction and interpretation applicable throughout this chapter.

History.

I.C., § 28-3-103, as added by 1993, ch. 288, § 2, p. 1019; am. 2002, ch. 121, § 1, p. 338; am. 2004, ch. 43, § 31, p. 136.

STATUTORY NOTES

Prior Laws.

Former § 28-3-103 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in paragraphs (1)(g) and (1)(j) and throughout subsections (2), (3) and (4) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

In implementing the conforming amendments to the revision of Article 1 by S.L. 2004, ch. 43, the state of Idaho did not delete the definition of "good faith" contained in subsection (1)(d) of this section, as did the uniform act. The following comments to this section were not updated to conform to the revised uniform comments.

CASE NOTES

Decisions Under Prior Law

Holder.

Assignee for purpose of collection was a holder within meaning of former statute. Craig v. Palo Alto Stock Farm, 16 Idaho 701, 102 P. 393 (1909).

Law raised presumption that title had passed to the holder. Home Land Co. v. Osborn, 19 Idaho 95, 112 P. 764 (1910).

Any person was authorized to bring action on promissory note who held it under proper authority and for the real owner thereof. Anderson v. Coolin,

28 Idaho 494, 155 P. 677 (1916).

Indorsee who was in possession of a promissory note was holder thereof and could sue thereon in his own name. Utah Implement-Vehicle Co. v. Kenyon, 30 Idaho 407, 164 P. 1176 (1917).

Official Comment

1. Subsection (a) defines some common terms used throughout the Article that were not defined by former Article 3 and adds the definitions of "order" and "promise" found in former Section 3-102(1)(b) and (c).

2. The definition of "order" includes an instruction given by the signer to itself. The most common example of this kind of order is a cashier's check: a draft with respect to which the drawer and drawee are the same bank or branches of the same bank. Former Section 3-118(a) treated a cashier's check as a note. It stated "a draft drawn on the drawer is effective as a note." Although it is technically more correct to treat a cashier's check as a promise by the issuing bank to pay rather than an order to pay, a cashier's check is in the form of a check and it is normally referred to as a check. Thus, revised Article 3 follows banking practice in referring to a cashier's check as both a draft and a check rather than a note. Some insurance companies also follow the practice of issuing drafts in which the drawer draws on itself and makes the draft payable at or through a bank. These instruments are also treated as drafts. The obligation of the drawer of a cashier's check or other draft drawn on the drawer is stated in Section 3-412.

An order may be addressed to more than one person as drawee either jointly or in the alternative. The authorization of alternative drawees follows former Section 3-102(1)(b) and recognizes the practice of drawers, such as corporations issuing dividend checks, who for commercial convenience name a number of drawees, usually in different parts of the country. Section 3-501(b)(1) provides that presentment may be made to any one of multiple drawees. Drawees in succession are not permitted because the holder should not be required to make more than one presentment. Dishonor by any drawee named in the draft entitles the holder to rights of recourse against the drawer or indorsers.

3. The last sentence of subsection (a)(9) is intended to make it clear that an I.O.U. or other written acknowledgement of indebtedness is not a note unless there is also an undertaking to pay the obligation.

4. Subsection (a)(4) introduces a definition of good faith to apply to Articles 3 and 4. Former Articles 3 and 4 used the definition in Section 1-201(19). The definition in subsection (a)(4) is consistent with the definitions of good faith applicable to Articles 2, 2A, 4, and 4A. The definition requires not only honesty in fact but also "observance of reasonable commercial standards of fair dealing." Although fair dealing is a broad term that must be defined in context, it is clear that it is concerned with the fairness of conduct rather than the care with which an act is performed. Failure to exercise ordinary care in conducting a transaction is an entirely different concept than failure to deal fairly in conducting the transaction. Both fair dealing and ordinary care, which is defined in Section 3-103(a)(7), are to be judged in the light of reasonable commercial standards, but those standards in each case are directed to different aspects of commercial conduct.

5. Subsection (a)(7) is a definition of ordinary care which is applicable not only to Article 3 but to Article 4 as well. See Section 4-104(c). The general rule is stated in the first sentence of subsection (a)(7) and it applies both to banks and to persons engaged in businesses other than banking. Ordinary care means observance of reasonable commercial standard of the relevant business prevailing in the area in which the person is located. The second sentence of subsection (a)(7) is a particular rule limited to the duty of a bank to examine an instrument taken by a bank for processing for collection or payment by automated means. This particular rule applies primarily to Section 4-406 and it is discussed in Comment 4 to that section. Nothing in Section 3-103(a)(7) is intended to prevent a customer from proving that the procedures followed by a bank are unreasonable, arbitrary, or unfair.

6. In subsection (c) reference is made to a new definition of "bank" in amended Article 4.

§ 28-3-104. Negotiable instrument. — (1) Except as provided in subsections (3) and (4) of this section, "negotiable instrument" means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:

(a) Is payable to bearer or to order at the time it is issued or first comes into possession of a holder;

(b) Is payable on demand or at a definite time; and

(c) Does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorization or power to the holder to confess judgment or realize on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.

(2) "Instrument" means a negotiable instrument.

(3) An order that meets all of the requirements of subsection (1) of this section, except paragraph (a), and otherwise falls within the definition of "check" in subsection (6) of this section is a negotiable instrument and a check.

(4) A promise or order other than a check is not an instrument if, at the time it is issued or first comes into possession of a holder, it contains a conspicuous statement, however expressed, to the effect that the promise or order is not negotiable or is not an instrument governed by this chapter.

(5) An instrument is a "note" if it is a promise and is a "draft" if it is an order. If an instrument falls within the definition of both "note" and "draft," a person entitled to enforce the instrument may treat it as either.

(6) "Check" means (i) a draft, other than a documentary draft, payable on demand and drawn on a bank, (ii) a cashier's check or teller's check, or (iii) a demand draft. An instrument may be a check even though it is described on its face by another term, such as "money order."

(7) “Cashier’s check” means a draft with respect to which the drawer and drawee are the same bank or branches of the same bank.

(8) “Teller’s check” means a draft drawn by a bank (i) on another bank, or (ii) payable at or through a bank.

(9) “Traveler’s check” means an instrument that (i) is payable on demand, (ii) is drawn on or payable at or through a bank, (iii) is designated by the term “traveler’s check” or by a substantially similar term, and (iv) requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the instrument.

(10) “Certificate of deposit” means an instrument containing an acknowledgment by a bank that a sum of money has been received by the bank and a promise by the bank to repay the sum of money. A certificate of deposit is a note of the bank.

(11) “Demand draft” means a writing not signed by the customer that is created by a third party under the purported authority of the customer for the purpose of charging the customer’s account with a bank. A demand draft shall contain the customer’s account number and may contain any or all of the following:

(a) The customer’s printed or typewritten name;

(b) A notation that the customer authorized the draft; or

(c) The statement “no signature required” or words to that effect.

“Demand draft” does not include a check purportedly drawn by and bearing the signature of a fiduciary, as defined in section 68-301, Idaho Code.

History.

I.C., § 28-3-104, as added by 1993, ch. 288, § 2, p. 1019; am. 2002, ch. 121, § 2, p. 338.

STATUTORY NOTES

Prior Laws.

Former § 28-3-104 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Cited Sirius LC v. Erickson, 144 Idaho 38, 156 P.3d 539 (2007); State v. Pelland, 159 Idaho 870, 367 P.3d 265 (Ct. App. 2016).

Decisions Under Prior Law

Application of Law.

Negotiable instruments law did not affect rights of parties to nonnegotiable instruments. Moody v. Morris-Roberts Co., 38 Idaho 414, 226 P. 278 (1923).

Attorney's Fees.

Provision in note that it was to be paid with costs of collection and attorney's fees in case of nonpayment before maturity did not destroy negotiability of instrument. Hutson v. Rankin, 36 Idaho 169, 213 P. 345 (1922).

Certainty as to Sum Payable.

So long as the amount payable was certain up to the time of maturity, it was not essential that after that time, when the instrument has become nonnegotiable for other reasons, certainty as to amount should continue. Hutson v. Rankin, 36 Idaho 169, 213 P. 345 (1922).

Conflict of Laws.

Negotiability of a note was determined by the law of the place of payment. McCornick & Co. v. Tolmie Bros., 46 Idaho 544, 269 P. 96 (1928).

Instruments Held Negotiable.

Bank was a holder in due course though material furnished by payee was allegedly defective and completion certificate was signed only by the wife, where the bank took the note which was regular on its face without any notice of alleged defects. United States v. Skinner, 137 F. Supp. 234 (D. Idaho 1956).

Note providing, "In case this note is collected by an attorney, either with or without suit, the maker agrees to pay a reasonable attorney's fee," was not deprived of negotiability by such provision. Hutson v. Rankin, 36 Idaho 169, 213 P. 345 (1922).

Acceleration clause, none of the conditions of which depended on act of holder or were in his control, did not destroy negotiability of note. McCornick & Co. v. Gem State Oil & Prods. Co., 38 Idaho 470, 222 P. 286 (1923).

Trade acceptances could have been negotiable instruments. Harris v. Sainsbury, 50 Idaho 502, 298 P. 360 (1931).

A trade acceptance, an instrument in the form of a draft, which recites that "the obligation of the acceptor hereof arises out of the purchase of goods from the drawer" was negotiable. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

Instruments Held Nonnegotiable.

County warrants were not negotiable paper in sense that transferee for value was protected from defenses available against original payee. Dexter Horton Trust & Sav. Bank v. Clearwater County, 235 F. 743 (D. Idaho 1916), aff'd, 248 F. 401 (9th Cir. 1918).

Promissory note containing stipulation whereby sureties, indorsers and makers waived notice of the granting of any extension of time for payment and waived right of defense on ground that extension had been made without notice to them or either of them, was not a "negotiable promissory

note." Union Stockyards Nat'l Bank v. Bolan, 14 Idaho 87, 93 P. 508 (1908).

Recital in a title-retaining note that title to property for which it was given should remain in payee and that he should have the right to take possession of it whenever he deemed himself insecure, even before maturity of note, rendered such instrument nonnegotiable. Kimpton v. Studebaker Bros. Co., 14 Idaho 552, 94 P. 1039 (1908); Wright v. Horton, 32 Idaho 516, 185 P. 555 (1919); Moyer v. Hyde, 35 Idaho 161, 204 P. 1068 (1922).

Note was nonnegotiable where time for payment was not fixed. Sanderson v. Clark, 33 Idaho 359, 194 P. 472 (1920).

Instrument which acknowledged receipt by bank of securities deposited with it in trust for insurance company, in compliance with state insurance laws, was held not negotiable. Radke v. Liberty Ins. Co., 37 Idaho 436, 216 P. 1040 (1923).

Note, negotiable in form, transferred by original payee after maturity, did not become negotiable instrument. Moody v. Morris-Roberts Co., 38 Idaho 414, 226 P. 278 (1923).

Notes attached to agency agreement and forming a part thereof were not negotiable, even though detached, when purchaser knew that they had been given in connection with written contracts and later detached. Security Fin. Co. v. Jensen Auto Co., 48 Idaho 376, 282 P. 88 (1929).

Receipts which provided that O would pay $2,000 "when K pays $2,500 note which I now hold against him which will be in about thirty days," was held not a negotiable instrument. Kite v. Eckley, 48 Idaho 454, 282 P. 868 (1929).

Nature and Effect of Check.

A check was an instrument by which a depositor sought to withdraw funds from a bank, and was evidence of indebtedness between drawer and payee. It was equivalent to the drawer's promise to pay and an action might be brought thereon as on a promissory note. Camas Prairie State Bank v. Newman, 15 Idaho 719, 99 P. 833 (1909).

A check is not cash and an appellant's deposit of his uncertified personal check is not a "deposit of money" in lieu of an appeal bond as provided by

§ 13-202. Martinson v. Martinson, 90 Idaho 490, 414 P.2d 204 (1966).

Note.

A note may be either negotiable or nonnegotiable; where the note is payable to specific persons, rather than to order or to bearer, the note is nonnegotiable, but it does not lose its character as a note. Spidell v. Jenkins, 111 Idaho 857, 727 P.2d 1285 (Ct. App. 1986).

Even if a "note" may not contain an express condition, the instrument, under which one party promised to perform specified services and the other party promised to pay for those services, was a "note" where the instrument did not expressly excuse the payor's promise if the performer failed to perform, and the payor did not expressly promise to pay only "if" the performer performed. Spidell v. Jenkins, 111 Idaho 857, 727 P.2d 1285 (Ct. App. 1986).

Although a negotiable instrument must contain an unconditional promise to pay, it does not necessarily follow that a note must be unconditional, because under the Uniform Commercial Code, a note may or may not be negotiable. Spidell v. Jenkins, 111 Idaho 857, 727 P.2d 1285 (Ct. App. 1986).

Option to Declare Due.

Where it was stipulated in a promissory note that "the whole sum of principal and interest shall become immediately due and collectible at the option of the holder of the note" if payment of interest and principal instalments were not made when due, such stipulation was a penalty and would not be enforced as to the interest not yet earned on the principal. Tipton v. Ellsworth, 18 Idaho 207, 109 P. 134 (1910).

Negotiability of a note was not destroyed by provision that, upon default in payment of interest on note, whole shall become due. Hutson v. Rankin, 36 Idaho 169, 213 P. 345 (1922).

Acceleration clause, none of the provisions of which depended on act of holder or were within his control, did not destroy negotiability of note. McCornick & Co. v. Gem State Oil & Prods. Co., 38 Idaho 470, 222 P. 286 (1923).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 7 et seq.

68A Am. Jur. 2d, Secured Transactions, § 158 et seq.

ALR. — What constitutes unconditional promise to pay under Uniform Commercial Code § 3-104(1)(b). 88 A.L.R.3d 1100.

What constitutes undertaking or instruction to do any act in addition to payment of money as limitation on definition of negotiable instrument under UCC § 3-104. 75 A.L.R.5th 559.

What constitutes "fixed amount of money" for purposes of [rev] § 3-104 of Uniform Commercial Code providing that negotiable instrument must contain unconditional promise to pay fixed amount of money. 76 A.L.R.5th 289.

When is instrument "payable to bearer or to order" as required to constitute negotiable instrument under Article 3 of the Uniform Commercial Code [rev] §§ 3-104(a)(1) and 3-109. 77 A.L.R.5th 523.

Official Comment

1. The definition of "negotiable instrument" defines the scope of Article 3 since Section 3-102 states: "This Article applies to negotiable instruments." The definition in Section 3-104(a) incorporates other definitions in Article 3. An instrument is either a "promise," defined in Section 3-103(a)(9), or "order," defined in Section 3-103(a)(6). A promise is a written undertaking to pay money signed by the person undertaking to pay. An order is a written instruction to pay money signed by the person giving the instruction. Thus, the term "negotiable instrument" is limited to a signed writing that orders or promises payment of money. "Money" is defined in Section 1-201(24) and is not limited to United States dollars. It also includes a medium of exchange established by a foreign government or monetary units of account established by an intergovernmental organization or by agreement between two or more nations. Five other requirements are stated in Section 3-104(a): First, the promise or order must be "unconditional." The quoted term is explained in Section 3-106. Second, the amount of money must be "a fixed amount *** with or without interest or other charges described in the promise or order." Section 3-112(b) relates to "interest." Third, the promise or order must be "payable to bearer or to order." The quoted phrase is

explained in Section 3-109. An exception to this requirement is stated in subsection (c). Fourth, the promise or order must be payable "on demand or at a definite time." The quoted phrase is explained in Section 3-108. Fifth, the promise or order may not state "any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money" with three exceptions. The quoted phrase is based on the first sentence of N.I.L. Section 5 which is the precursor of "no other promise, order, obligation or power given by the maker or drawer" appearing in former Section 3-104(1)(b). The words "instruction" and "undertaking" are used instead of "order" and "promise" that are used in the N.I.L. formulation because the latter words are defined terms that include only orders or promises to pay money. The three exceptions stated in Section 3-104(a)(3) are based on and are intended to have the same meaning as former Section 3-112(1)(b), (c), (d), and (e), as well as N.I.L. § 5(1), (2), and (3). Subsection (b) states that "instrument" means a "negotiable instrument." This follows former Section 3-102(1)(e) which treated the two terms as synonymous.

2. Unless subsection (c) applies, the effect of subsection (a)(1) and Section 3-102(a) is to exclude from Article 3 any promise or order that is not payable to bearer or to order. There is no provision in revised Article 3 that is comparable to former Section 3-805. The Comment to former Section 3-805 states that the typical example of a writing covered by that section is a check reading "Pay John Doe." Such a check was governed by former Article 3 but there could not be a holder in due course of the check. Under Section 3-104(c) such a check is governed by revised Article 3 and there can be a holder in due course of the check. But subsection (c) applies only to checks. The Comment to former Section 3-805 does not state any example other than the check to illustrate that section. Subsection (c) is based on the belief that is it good policy to treat checks, which are payment instruments, as negotiable instruments whether or not they contain the words "to the order of". These words are almost always preprinted on the check form. Occasionally the drawer of a check may strike out these words before issuing the check. In the past some credit unions used check forms that did not contain the quoted words. Such check forms may still be in use but they are no longer common. Absence of the quoted words can easily be overlooked and should not affect the rights of holders who may pay money

or give credit for a check without being aware that it is not in the conventional form.

Total exclusion from Article 3 of other promises or orders that are not payable to bearer or to order serves a useful purpose. It provides a simple device to clearly exclude a writing that does not fit the pattern of typical negotiable instruments and which is not intended to be a negotiable instrument. If a writing could be an instrument despite the absence of "to order" or "to bearer" language and a dispute arises with respect to the writing, it might be argued that the writing is a negotiable instrument because the other requirements of subsection (a) are somehow met. Even if the argument is eventually found to be without merit it can be used as a litigation ploy. Words making a promise or order payable to bearer or to order are the most distinguishing feature of a negotiable instrument and such words are frequently referred to as "words of negotiability." Article 3 is not meant to apply to contracts for the sale of goods or services or the sale or lease of real property or similar writings that may contain a promise to pay money. The use of words of negotiability in such contracts would be an aberration. Absence of the words precludes any argument that such contracts might be negotiable instruments.

An order or promise that is excluded from Article 3 because of the requirements of Section 3-104(a) may nevertheless be similar to a negotiable instrument in many respects. Although such a writing cannot be made a negotiable instrument within Article 3 by contract or conduct of its parties, nothing in Section 3-104 or in Section 3-102 is intended to mean that in a particular case involving such a writing a court could not arrive at a result similar to the result that would follow if the writing were a negotiable instrument. For example, a court might find that the obligor with respect to a promise that does not fall within Section 3-104(a) is precluded from asserting a defense against a bona fide purchaser. The preclusion could be based on estoppel or ordinary principles of contract. It does not depend upon the law of negotiable instruments. An example is stated in the paragraph following Case # 2 in Comment 4 to Section 3-302.

Moreover, consistent with the principle stated in Section 1-102(2)(b), the immediate parties to an order or promise that is not an instrument may provide by agreement that one or more of the provisions of Article 3 determine their rights and obligations under the writing. Upholding the

parties' choice is not inconsistent with Article 3. Such an agreement may bind a transferee of the writing if the transferee has notice of it or the agreement arises from usage of trade and the agreement does not violate other law or public policy. An example of such an agreement is a provision that a transferee of the writing has the rights of a holder in due course stated in Article 3 if the transferee took rights under the writing in good faith, for value, and without notice of a claim or defense.

Even without an agreement of the parties to an order or promise that is not an instrument, it may be appropriate, consistent with the principles stated in Section 1-102(2), for a court to apply one or more provisions of Article 3 to the writing by analogy, taking into account the expectations of the parties and the differences between the writing and an instrument governed by Article 3. Whether such application is appropriate depends upon the facts of each case.

3. Subsection (d) allows exclusion from Article 3 of a writing that would otherwise be an instrument under subsection (a) by a statement to the effect that the writing is not negotiable or is not governed by Article 3. For example, a promissory note can be stamped with the legend NOT NEGOTIABLE. The effect under subsection (d) is not only to negate the possibility of a holder in due course, but to prevent the writing from being a negotiable instrument for any purpose. Subsection (d) does not, however, apply to a check. If a writing is excluded from Article 3 by subsection (d), a court could, nevertheless, apply Article 3 principles to it by analogy as stated in Comment 2.

4. Instruments are divided into two general categories: drafts and notes. A draft is an instrument that is an order. A note is an instrument that is a promise. Section 3-104(e). The term "bill of exchange" is not used in Article 3. It is generally understood to be a synonym for the term "draft." Subsection (f) through (j) define particular instruments that fall within the categories of draft and note. The term "draft," defined in subsection (e), includes a "check" which is defined in subsection (f). "Check" includes a share draft drawn on a credit union payable through a bank because the definition of bank (Section 4-105) includes credit unions. However, a draft drawn on an insurance company payable through a bank is not a check because it is not drawn on a bank. "Money orders" are sold both by banks and nonbanks. They vary in form and their form determines how they are

treated in Article 3. The most common form of money order sold by banks is that of an ordinary check drawn by the purchaser except that the amount is machine impressed. That kind of money order is a check under Article 3 and is subject to a stop order by the purchaser-drawer as in the case of ordinary checks. The seller bank is the drawee and has no obligation to a holder to pay the money order. If a money order falls within the definition of a teller's check, the rules applicable to teller's checks apply. Postal money orders are subject to federal law. "Teller's check" is separately defined in subsection (h). A teller's check is always drawn by a bank and is usually drawn on another bank. In some cases a teller's check is drawn on a nonbank but is made payable at or through a bank. Article 3 treats both types of teller's check identically, and both are included in the definition of "check." A cashier's check, defined in subsection (g), is also included in the definition of "check." Traveler's checks are issued both by banks and nonbanks and may be in the form of a note or draft. Subsection (i) states the essential characteristics of a traveler's check. The requirement that the instrument be "drawn on or payable at or through a bank" may be satisfied without words on the instrument that identify a bank as drawee or paying agent so long as the instrument bears an appropriate routing number that identifies a bank as paying agent.

The definitions in Regulation CC § 229.2 of the terms "check," "cashier's check," "teller's check," and "traveler's check" are different from the definitions of those terms in Article 3.

Certificates of deposit are treated in former Article 3 as a separate type of instrument. In revised Article 3, Section 3-104(j) treats them as notes.

5. There are some differences between the requirements of Article 3 and the requirements included in Article 3 of the Convention on International Bills of Exchange and International Promissory Notes. Most obviously, the Convention does not include the limitation on extraneous undertakings set forth in Section 3-104(a)(3), and does not permit documents payable to bearer that would be permissible under Section 3-104(a)(1) and Section 3-109. See Convention Article 3. In most respects, however, the requirements of Section 3-104 and Article 3 of the Convention are quite similar.

§ 28-3-105. Issue of instrument. — (1) "Issue" means the first delivery of an instrument by the maker or drawer, whether to a holder or nonholder, for the purpose of giving rights on the instrument to any person.

(2) An unissued instrument, or an unissued incomplete instrument that is completed, is binding on the maker or drawer, but nonissuance is a defense. An instrument that is conditionally issued or is issued for a special purpose is binding on the maker or drawer, but failure of the condition or special purpose to be fulfilled is a defense.

(3) "Issuer" applies to issued and unissued instruments and means a maker or drawer of an instrument.

History.

I.C., § 28-3-105, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-105 was repealed. See Prior Laws, § 28-3-101.

Official Comment

1. Under former Section 3-102(1)(a) "issue" was defined as the first delivery to a "holder or a remitter" but the term "remitter" was neither defined nor otherwise used. In revised Article 3, Section 3-105(a) defines "issue" more broadly to include the first delivery to anyone by the drawer or maker for the purpose of giving rights to anyone on the instrument. "Delivery" with respect to instruments is defined in Section 1-201(14) as meaning "voluntary transfer of possession."

2. Subsection (b) continues the rule that nonissuance, conditional issuance or issuance for a special purpose is a defense of the maker or drawer of an instrument. Thus, the defense can be asserted against a person other than a holder in due course. The same rule applies to nonissuance of an incomplete instrument later completed.

3. Subsection (c) defines "issuer" to include the signer of an unissued instrument for convenience of reference in the statute.

§ 28-3-106. Unconditional promise or order. — (1) Except as provided in this section, for the purposes of section 28-3-104(1)[, Idaho Code], a promise or order is unconditional unless it states (i) an express condition to payment, (ii) that the promise or order is subject to or governed by another writing, or (iii) that rights or obligations with respect to the promise or order are stated in another writing. A reference to another writing does not of itself make the promise or order conditional.

(2) A promise or order is not made conditional (i) by a reference to another writing for a statement of rights with respect to collateral, prepayment, or acceleration, or (ii) because payment is limited to resort to a particular fund or source.

(3) If a promise or order requires, as a condition to payment, a countersignature by a person whose specimen signature appears on the promise or order, the condition does not make the promise or order conditional for the purposes of section 28-3-104(1)[, Idaho Code]. If the person whose specimen signature appears on an instrument fails to countersign the instrument, the failure to countersign is a defense to the obligation of the issuer, but the failure does not prevent a transferee of the instrument from becoming a holder of the instrument.

(4) If a promise or order at the time it is issued or first comes into possession of a holder contains a statement, required by applicable statutory or administrative law, to the effect that the rights of a holder or transferee are subject to claims or defenses that the issuer could assert against the original payee, the promise or order is not thereby made conditional for the purposes of section 28-3-104(1)[, Idaho Code]; but if the promise or order is an instrument, there cannot be a holder in due course of the instrument.

History.

I.C., § 28-3-106, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-106 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (1), (3), and (4) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Statement of transaction.

Title-retaining note.

Unconditional.

Statement of Transaction.

Instrument was not deprived of negotiability by the first sentence in the margin thereof, stating that "the obligation of the acceptor of this bill arises out of the purchase of goods from the drawer." McCornick & Co. v. Gem State Oil & Prods. Co., 38 Idaho 470, 222 P. 286 (1923).

Title-Retaining Note.

Recital in title-retaining note that title to property for which it was given should remain in payee and that he should have the right to take possession of it whenever he might deem himself insecure, even before maturity of note, rendered such instrument nonnegotiable under former law. Kimpton v. Studebaker Bros. Co., 14 Idaho 552, 94 P. 1039 (1908).

Unconditional.

Even if a "note" may not contain an express condition, the instrument, under which one party promised to perform specified services and the other party promised to pay for those services, was a "note" where the instrument did not expressly excuse the payor's promise if the performer failed to perform, and the payor did not expressly promise to pay only "if" the performer performed. Spidell v. Jenkins, 111 Idaho 857, 727 P.2d 1285 (Ct. App. 1986).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 74 et seq.

Official Comment

1. This provision replaces former Section 3-105. Its purpose is to define when a promise or order fulfills the requirement in Section 3-104(a) that it be an "unconditional" promise or order to pay. Under Section 3-106(a) a promise or order is deemed to be unconditional unless one of the two tests of the subsection make the promise or order conditional. If the promise or order states an express condition to payment, the promise or order is not an instrument. For example, a promise states, "I promise to pay $100,000 to the order of John Doe if he conveys title to Blackacre to me." The promise is not an instrument because there is an express condition to payment. However, suppose a promise states, "In consideration of John Doe's promise to convey title to Blackacre I promise to pay $100,000 to the order of John Doe." That promise can be an instrument if Section 3-104 is otherwise satisfied. Although the recital of the executory promise of Doe to convey Blackacre might be read as an implied condition that the promise be performed, the condition is not an express condition as required by Section 3-106(a)(i). This result is consistent with former Section 3-105(1)(a) and (b). Former Section 3-105(1)(b) is not repeated in Section 3-106 because it is not necessary. It is an example of an implied condition. Former Section 3-105(1)(d), (e), and (f) and the first clause of former Section 3-105(1)(c) are other examples of implied conditions. They are not repeated in Section 3-106 because they are not necessary. The law is not changed.

Section 3-106(a)(ii) and (iii) carry forward the substance of former Section 3-105(2)(a). The only change is the use of "writing" instead of "agreement" and a broadening of the language that can result in conditionality. For example, a promissory note is not an instrument defined by Section 3-104 if it contains any of the following statements: 1. "This note is subject to a contract of sale dated April 1, 1990 between the payee and maker of this note." 2. "This note is subject to a loan and security agreement dated April 1, 1990 between the payee and maker of this note." 3. "Rights and obligations of the parties with respect to this note are stated in an agreement dated April 1, 1990 between the payee and maker of this note." It is not relevant whether any condition to payment is or is not stated in the writing to which reference is made. The rationale is that the holder of

a negotiable instrument should not be required to examine another document to determine rights with respect to payment. But subsection (b)(i) permits reference to a separate writing for information with respect to collateral, prepayment, or acceleration.

Many notes issued in commercial transactions are secured by collateral, are subject to acceleration in the event of default, or are subject to prepayment. A statement of rights and obligations concerning collateral, prepayment, or acceleration does not prevent the note from being an instrument if the statement is in the note itself. See Section 3-104(a)(3) and Section 3-108(b). In some cases it may be convenient not to include a statement concerning collateral, prepayment, or acceleration in the note, but rather to refer to an accompanying loan agreement, security agreement or mortgage for that statement. Subsection (b)(i) allows a reference to the appropriate writing for a statement of these rights. For example, a note would not be made conditional by the following statement: "This note is secured by a security interest in collateral described in a security agreement dated April 1, 1990 between the payee and maker of this note. Rights and obligations with respect to the collateral are [stated in] [governed by] the security agreement." The bracketed words are alternatives, either of which complies.

Subsection (b)(ii) addresses the issues covered by former Section 3-105(1)(f), (g), and (h) and Section 3-105(2)(b). Under Section 3-106(a) a promise or order is not made conditional because payment is limited to payment from a particular source or fund. This reverses the result of former Section 3-105(2)(b). There is no cogent reason why the general credit of a legal entity must be pledged to have a negotiable instrument. Market forces determine the marketability of instruments of this kind. If potential buyers don't want promises or orders that are payable only from a particular source or fund, they won't take them, but Article 3 should apply.

2. Subsection (c) applies to traveler's checks or other instruments that may require a countersignature. Although the requirement of a countersignature is a condition to the obligation to pay, traveler's checks are treated in the commercial world as money substitutes and therefore should be governed by Article 3. The first sentence of subsection (c) allows a traveler's check to meet the definition of instrument by stating that the countersignature condition does not make it conditional for the purposes of

Section 3-104. The second sentence states the effect of a failure to meet the condition. Suppose a thief steals a traveler's check and cashes it by skillfully imitating the specimen signature so that the countersignature appears to be authentic. The countersignature is for the purpose of identification of the owner of the instrument. It is not an indorsement. Subsection (c) provides that the failure of the owner to countersign does not prevent a transferee from becoming a holder. Thus, the merchant or bank that cashed the traveler's check becomes a holder when the traveler's check is taken. The forged countersignature is a defense to the obligation of the issuer to pay the instrument, and is included in defenses under Section 3-305(a)(2). These defenses may not be asserted against a holder in due course. Whether a holder has notice of the defense is a factual question. If the countersignature is a very bad forgery, there may be notice. But if the merchant or bank cashed a traveler's check and the countersignature appeared to be similar to the specimen signature, there might not be notice that the countersignature was forged. Thus, the merchant or bank could be a holder in due course.

3. Subsection (d) concerns the effect of a statement to the effect that the rights of a holder or transferee are subject to claims and defenses that the issuer could assert against the original payee. The subsection applies only if the statement is required by statutory or administrative law. The prime example is the Federal Trade Commission Rule (16 C.F.R. Part 433) preserving consumers' claims and defenses in consumer credit sales. The intent of the FTC rule is to make it impossible for there to be a holder in due course of a note bearing the FTC legend and undoubtedly that is the result. But, under former Article 3, the legend may also have had the unintended effect of making the note conditional, thus excluding the note from former Article 3 altogether. Subsection (d) is designed to make it possible to preclude the possibility of a holder in due course without excluding the instrument from Article 3. Most of the provisions of Article 3 are not affected by the holder-in-due-course doctrine and there is no reason why Article 3 should not apply to a note bearing the FTC legend if holder-in-due-course rights are not involved. Under subsection (d) the statement does not make the note conditional. If the note otherwise meets the requirements of Section 3-104(a) it is a negotiable instrument for all purposes except that there cannot be a holder in due course of the note. No particular form of legend or statement is required by subsection (d). The

form of a particular legend or statement may be determined by the other statute or administrative law. For example, the FTC legend required in a note taken by the seller in a consumer sale of goods or services is tailored to that particular transaction and therefore uses language that is somewhat different from that stated in subsection (d), but the difference in expression does not affect the essential similarity of the message conveyed. The effect of the FTC legend is to make the rights of a holder or transferee subject to claims or defenses that the issuer could assert against the original payee of the note.

§ 28-3-107. Instrument payable in foreign money. — Unless the instrument otherwise provides, an instrument that states the amount payable in foreign money may be paid in the foreign money or in an equivalent amount in dollars calculated by using the current bank-offered spot rate at the place of payment for the purchase of dollars on the day on which the instrument is paid.

History.

I.C., § 28-3-107, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-107 was repealed. See Prior Laws, § 28-3-101.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 112.

Official Comment The definition of instrument in Section 3-104 requires that the promise or order be payable in "money." That term is defined in Section 1-201(24) and is not limited to United States dollars. Section 3-107 states than an instrument payable in foreign money may be paid in dollars if the instrument does not prohibit it. It also states a conversion rate which applies in the absence of a different conversion rate stated in the instrument. The reference in former Section 3-107(1) to instruments payable in "currency" or "current funds" has been dropped as superfluous.

§ 28-3-108. Payable on demand or at definite time. — (1) A promise or order is "payable on demand" if it (i) states that it is payable on demand or at sight, or otherwise indicates that it is payable at the will of the holder, or (ii) does not state any time of payment.

(2) A promise or order is "payable at a definite time" if it is payable on elapse of a definite period of time after sight or acceptance or at a fixed date or dates or at a time or times readily ascertainable at the time the promise or order is issued, subject to rights of (i) prepayment, (ii) acceleration, (iii) extension at the option of the holder, or (iv) extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event.

(3) If an instrument, payable at a fixed date, is also payable upon demand made before the fixed date, the instrument is payable on demand until the fixed date and, if demand for payment is not made before that date, becomes payable at a definite time on the fixed date.

History.

I.C., § 28-3-108, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-108 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Cited Corliss v. Wenner, 136 Idaho 417, 34 P.3d 1100 (Ct. App. 2001).

Decisions Under Prior Law

Option to declare due.

Reasonable time.

Option to Declare Due.

Where it was stipulated in promissory note, that "principal and interest shall become immediately due and collectible at the option of the holder of the note" if payment of interest and principal installments are not made when due, such stipulation is a penalty and will not be enforced as to the interest not yet earned on the principal. Tipton v. Ellsworth, 18 Idaho 207, 109 P. 134 (1910).

Negotiability of note was not destroyed by provision that, upon default in payment of interest on note, whole shall become due. Hutson v. Rankin, 36 Idaho 169, 213 P. 345 (1922).

Acceleration clause, none of the provisions of which depend on act of holder or are in his control, did not destroy negotiability of note. McCornick & Co. v. Gem State Oil & Prods. Co., 38 Idaho 470, 222 P. 286 (1923).

Reasonable Time.

As a general rule, question of what was a reasonable length of time in which to present for payment a promissory note which was indorsed after maturity was one of fact to be determined by circumstances of each particular case. Sheffield v. Cleland, 19 Idaho 612, 115 P. 20 (1911).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d Bills and Notes, § 86 et seq.

Official Comment

This section is a restatement of former Section 3-108 and Section 3-109. Subsection (b) broadens former Section 3-109 somewhat by providing that a definite time includes a time readily ascertainable at the time the promise or order is issued. Subsection (b)(iii) and (iv) restates former Section 3-109(1)(d). It adopts the generally accepted rule that a clause providing for extension at the option of the holder, even without a time limit, does not affect negotiability since the holder is given only a right which the holder would have without the clause. If the extension is to be at the option of the maker or acceptor or is to be automatic, a definite time limit must be stated or the time of payment remains uncertain and the order or promise is not a negotiable instrument. If a definite time limit is stated, the effect upon

certainty of time of payment is the same as if the instrument were made payable at the ultimate date with a term providing for acceleration.

§ 28-3-109. Payable to bearer or to order. — (1) A promise or order is payable to bearer if it:

(a) States that it is payable to bearer or to the order of bearer or otherwise indicates that the person in possession of the promise or order is entitled to payment; (b) Does not state a payee; or (c) States that it is payable to or to the order of cash or otherwise indicates that it is not payable to an identified person.

(2) A promise or order that is not payable to bearer is payable to order if it is payable (i) to the order of an identified person, or (ii) to an identified person or order. A promise or order that is payable to order is payable to the identified person.

(3) An instrument payable to bearer may become payable to an identified person if it is specially indorsed pursuant to section 28-3-205(1)[, Idaho Code]. An instrument payable to an identified person may become payable to bearer if it is indorsed in blank pursuant to section 28-3-205(2)[, Idaho Code].

History.

I.C., § 28-3-109, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-109 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (3) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Governed by Contract Law.

Promissory note was not payable to bearer because it specifically identified the person to whom payment was to be made, the company, and even though the note was payable to an identified person, it was not payable to order because it lacked the required words of negotiability “to order.” Sirius LC v. Erickson, 144 Idaho 38, 156 P.3d 539 (2007).

Decisions Under Prior Law Fictitious Payee.

Where payee named never owned or received delivery of note and note was delivered to holder who lent money to makers, payee was fictitious and note was payable to bearer. Ritter v. Moore, 64 Idaho 144, 128 P.2d 639 (1942).

RESEARCH REFERENCES

ALR. — When is instrument “payable to bearer or to order” as required to constitute negotiable instrument under Article 3 of the Uniform Commercial Code [rev] §§ 3-104(a)(1) and 3-109. 77 A.L.R.5th 523.

Official Comment

1. Under Section 3-104(a), a promise or order cannot be an instrument unless the instrument is payable to bearer or to order when it is issued or unless Section 3-104(c) applies. The terms “payable to bearer” and “payable to order” are defined in Section 3-109. The quoted terms are also relevant in determining how an instrument is negotiated. If the instrument is payable to bearer it can be negotiated by delivery alone. Section 3-201(b). An instrument that is payable to an identified person cannot be negotiated without the indorsement of the identified person. Section 3-201(b). An instrument payable to order is payable to an identified person. Section 3-109(b). Thus, an instrument payable to order requires the indorsement of the person to whose order the instrument is payable.

2. Subsection (a) states when an instrument is payable to bearer. An instrument is payable to bearer if it states that it is payable to bearer, but some instruments use ambiguous terms. For example, check forms usually have the words “to the order of” printed at the beginning of the line to be filled in for the name of the payee. If the drawer writes in the word “bearer” or “cash,” the check reads “to the order of bearer” or “to the order of cash.”

In each case the check is payable to bearer. Sometimes the drawer will write the name of the payee "John Doe" but will add the words "or bearer." In that case the check is payable to bearer. Subsection (a). Under subsection (b), if an instrument is payable to bearer it can't be payable to order. This is different from former Section 3-110(3). An instrument that purports to be payable both to order and bearer states contradictory terms. A transferee of the instrument should be able to rely on the bearer term and acquire rights as a holder without obtaining the indorsement of the identified payee. An instrument is also payable to bearer if it does not state a payee. Instruments that do not state a payee are in most cases incomplete instruments. In some cases the drawer of a check may deliver or mail it to the person to be paid without filling in the line for the name of the payee. Under subsection (a) the check is payable to bearer when it is sent or delivered. It is also an incomplete instrument. This case is discussed in Comment 2 to Section 3-115. Subsection (a)(3) contains the words "otherwise indicates that it is not payable to an identified person." The quoted words are meant to cover uncommon cases in which an instrument indicates that it is not meant to be payable to a specific person. Such an instrument is treated like a check payable to "cash." The quoted words are not meant to apply to an instrument stating that it is payable to an identified person such as "ABC Corporation" if ABC Corporation is a nonexistent company. Although the holder of the check cannot be the nonexistent company, the instrument is not payable to bearer. Negotiation of such an instrument is governed by Section 3-404(b).

§ 28-3-110. Identification of person to whom instrument is payable. — (1) The person to whom an instrument is initially payable is determined by the intent of the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument. The instrument is payable to the person intended by the signer even if that person is identified in the instrument by a name or other identification that is not that of the intended person. If more than one (1) person signs in the name or behalf of the issuer of an instrument and all the signers do not intend the same person as payee, the instrument is payable to any person intended by one (1) or more of the signers.

(2) If the signature of the issuer of an instrument is made by automated means, such as a check-writing machine, the payee of the instrument is determined by the intent of the person who supplied the name or identification of the payee, whether or not authorized to do so.

(3) A person to whom an instrument is payable may be identified in any way, including by name, identifying number, office or account number. For the purpose of determining the holder of an instrument, the following rules apply:

(a) If an instrument is payable to an account and the account is identified only by number, the instrument is payable to the person to whom the account is payable. If an instrument is payable to an account identified by number and by the name of a person, the instrument is payable to the named person, whether or not that person is the owner of the account identified by number.

(b) If an instrument is payable to:

(i) A trust, an estate or a person described as trustee or representative of a trust or estate, the instrument is payable to the trustee, the representative or a successor of either, whether or not the beneficiary or estate is also named;

(ii) A person described as agent or similar representative of a named or identified person, the instrument is payable to the represented person, the representative, or a successor of the representative;

(iii) A fund or organization that is not a legal entity, the instrument is payable to a representative of the members of the fund or organization; or

(iv) An office or to a person described as holding an office, the instrument is payable to the named person, the incumbent of the office, or a successor to the incumbent.

(4) If an instrument is payable to two (2) or more persons alternatively, it is payable to any of them and may be negotiated, discharged, or enforced by any or all of them in possession of the instrument. If an instrument is payable to two (2) or more persons not alternatively, it is payable to all of them and may be negotiated, discharged, or enforced only by all of them. If an instrument payable to two (2) or more persons is ambiguous as to whether it is payable to the persons alternatively, the instrument is payable to the persons alternatively.

History.

I.C., § 28-3-110, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-110 was repealed. See Prior Laws, § 28-3-101.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 53 et seq.

Official Comment

1. Section 3-110 states rules for determining the identity of the person to whom an instrument is initially payable if the instrument is payable to an identified person. This issue usually arises in a dispute over the validity of an indorsement in the name of the payee. Subsection (a) states the general rule that the person to whom an instrument is payable is determined by the intent of "the person, whether or not authorized, signing as, or in the name or behalf of, the issuer of the instrument." "Issuer" means the maker or drawer of the instrument. Section 3-105(c). If X signs a check as drawer of

a check on X's account, the intent of X controls. If X, as President of Corporation, signs a check as President in behalf of Corporation as drawer, the intent of X controls. If X forges Y's signature as drawer of a check, the intent of X also controls. Under Section 3-103(a)(3), Y is referred to as the drawer of the check because the signing of Y's name identifies Y as the drawer. But since Y's signature was forged Y has no liability as drawer (Section 3-403(a)) unless some other provision of Article 3 or Article 4 makes Y liable. Since X, even though unauthorized, signed in the name of Y as issuer, the intent of X determines to whom the check is payable.

In the case of a check payable to "John Smith," since there are many people in the world named "John Smith" it is not possible to identify the payee of the check unless there is some further identification or the intention of the drawer is determined. Name alone is sufficient under subsection (a), but the intention of the drawer determines which John Smith is the person to whom the check is payable. The same issue is presented in cases of misdescriptions of the payee. The drawer intends to pay a person known to the drawer as John Smith. In fact that person's name is James Smith or John Jones or some other entirely different name. If the check identifies the payee as John Smith, it is nevertheless payable to the person intended by the drawer. That person may indorse the check in either the name John Smith or the person's correct name or in both names. Section 3-204(d). The intent of the drawer is also controlling in fictitious payee cases. Section 3-404(b). The last sentence of subsection (a) refers to rare cases in which the signature of an organization requires more than one signature and the persons signing on behalf of the organization do not all intend the same person as payee. Any person intended by a signer for the organization is the payee and an indorsement by that person is an effective indorsement.

Subsection (b) recognizes the fact that in a large number of cases there is no human signer of an instrument because the instrument, usually a check, is produced by automated means such as a check-writing machine. In that case, the relevant intent is that of the person who supplied the name of the payee. In most cases that person is an employee of the drawer, but in some cases the person could be an outsider who is committing a fraud by introducing names of payees of checks into the system that produces the checks. A check-writing machine is likely to be operated by means of a computer in which is stored information as to name and address of the

payee and the amount of the check. Access to the computer may allow production of fraudulent checks without knowledge of the organization that is the issuer of the check. Section 3-404(b) is also concerned with this issue. See Case #4 in Comment 2 to Section 3-404.

2. Subsection (c) allows the payee to be identified in any way including the various ways stated. Subsection (c)(1) relates to instruments payable to bank accounts. In some cases the account might be identified by name and number, and the name and number might refer to different persons. For example, a check is payable to "X Corporation Account No. 12345 in Bank of Podunk." Under the last sentence of subsection (c)(1), this check is payable to X Corporation and can be negotiated by X Corporation even if Account No. 12345 is some other person's account or the check is not deposited in that account. In other cases the payee is identified by an account number and the name of the owner of the account is not stated. For example, Debtor pays Creditor by issuing a check drawn on Payor Bank. The check is payable to a bank account owned by Creditor but identified only by number. Under the first sentence of subsection (c)(1) the check is payable to Creditor and, under Section 1-201(20), Creditor becomes the holder when the check is delivered. Under Section 3-201(b), further negotiation of the check requires the indorsement of Creditor. But under Section 4-205(a), if the check is taken by a depositary bank for collection, the bank may become a holder without the indorsement. Under Section 3-102(b), provisions of Article 4 prevail over those of Article 3. The depositary bank warrants that the amount of the check was credited to the payee's account.

3. Subsection (c)(2) replaces former Section 3-117 and subsection (1)(e), (f), and (g) of former Section 3-110. This provision merely determines who can deal with an instrument as a holder. It does not determine ownership of the instrument or its proceeds. Subsection (c)(2)(i) covers trusts and estates. If the instrument is payable to the trust or estate or to the trustee or representative of the trust or estate, the instrument is payable to the trustee or representative or any successor. Under subsection (c)(2)(ii), if the instrument states that it is payable to Doe, President of X Corporation, either Doe or X Corporation can be holder of the instrument. Subsection (c)(2)(iii) concerns informal organizations that are not legal entities such as unincorporated clubs and the like. Any representative of the members of the

organization can act as holder. Subsection (c)(2)(iv) applies principally to instruments payable to public offices such as a check payable to County Tax Collector.

4. Subsection (d) replaces former Section 3-116. An instrument payable to X or Y is governed by the first sentence of subsection (d). An instrument payable to X and Y is governed by the second sentence of subsection (d). If an instrument is payable to X or Y, either is the payee and if either is in possession that person is the holder and the person entitled to enforce the instrument. Section 3-301. If an instrument is payable to X and Y, neither X nor Y acting alone is the person to whom the instrument is payable. Neither person, acting alone, can be the holder of the instrument. The instrument is “payable to an identified person.” The “identified person” is X and Y acting jointly. Section 3-109(b) and Section 1-102(5)(a). Thus, under Section 1-201(20) X or Y, acting alone, cannot be the holder or the person entitled to enforce or negotiate the instrument because neither, acting alone, is the identified person stated in the instrument.

The third sentence of subsection (d) is directed to cases in which it is not clear whether an instrument is payable to multiple payees alternatively. In the case of ambiguity persons dealing with the instrument should be able to rely on the indorsement of a single payee. For example, an instrument payable to X and/or Y is treated like an instrument payable to X or Y.

§ 28-3-111. Place of payment. — Except as otherwise provided for items in chapter 4[, title 28, Idaho Code], an instrument is payable at the place of payment stated in the instrument. If no place of payment is stated, an instrument is payable at the address of the drawee or maker stated in the instrument. If no address is stated, the place of payment is the place of business of the drawee or maker. If a drawee or maker has more than one (1) place of business, the place of payment is any place of business of the drawee or maker chosen by the person entitled to enforce the instrument. If the drawee or maker has no place of business, the place of payment is the residence of the drawee or maker.

History.

I.C., § 28-3-111, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-111 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in the first sentence was added by the compiler to conform to the statutory citation style.

Official Comment If an instrument is payable at a bank in the United States, Section 3-501(b)(1) states that presentment must be made at the place of payment, *i.e.* the bank. The place of presentment of a check is governed by Regulation CC § 229.36.

§ 28-3-112. Interest. — (1) Unless otherwise provided in the instrument, (i) an instrument is not payable with interest, and (ii) interest on an interest-bearing instrument is payable from the date of the instrument.

(2) Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues.

History.

I.C., § 28-3-112, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-112 was repealed. See Prior Laws, § 28-3-101.

Official Comment 1. Under Section 3-104(a) the requirement of a "fixed amount" applies only to principal. The amount of interest payable is that described in the instrument. If the description of interest in the instrument does not allow for the amount of interest to be ascertained, interest is payable at the judgment rate. Hence, if an instrument calls for interest, the amount of interest will always be determinable. If a variable rate of interest is prescribed, the amount of interest is ascertainable by reference to the formula or index described or referred to in the instrument. The last sentence of subsection (b) replaces subsection (d) of former Section 3-118.

2. The purpose of subsection (b) is to clarify the meaning of "interest" in the introductory clause of Section 3-104(a). It is not intended to validate a provision for interest in an instrument if that provision violates other law.

§ 28-3-113. Date of instrument. — (1) An instrument may be antedated or postdated. The date stated determines the time of payment if the instrument is payable at a fixed period after date. Except as provided in section 28-4-401(3)[, Idaho Code], an instrument payable on demand is not payable before the date of the instrument.

(2) If an instrument is undated, its date is the date of its issue or, in the case of an unissued instrument, the date it first comes into possession of a holder.

History.

I.C., § 28-3-113, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-113 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in subsection (1) was added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law Certified check.

Postdated check.

Certified Check.

Where bank on which postdated check was drawn certified it, liability of bank attached from time of certification, irrespective of date which check bore. Smith v. Field, 19 Idaho 558, 114 P. 668 (1911).

Postdated Check.

Postdated check is in effect a note. Noall v. Dickinson, 49 Idaho 706, 292 P. 219 (1930).

Official Comment

This section replaces former Section 3-114. Subsections (1) and (3) of former Section 3-114 are deleted as unnecessary. Section 3-113(a) is based in part on subsection (2) of former Section 3-114. The rule that a demand instrument is not payable before the date of the instrument is subject to Section 4-401(c) which allows the payor bank to pay a postdated check unless the drawer has notified the bank of the postdating pursuant to a procedure prescribed in that subsection. With respect to an undated instrument, the date is the date of issue.

§ 28-3-114. Contradictory terms of instrument. — If an instrument contains contradictory terms, typewritten terms prevail over printed terms, handwritten terms prevail over both, and words prevail over numbers.

History.

I.C., § 28-3-114, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-114 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law Contract of guaranty.

Liability of indorser.

Contract of Guaranty.

Contract of guaranty indorsed upon the back of a promissory note in the following words: "For value received I hereby guarantee payment of the within note and waive protest, demand and notice for nonpayment thereof," was a several as well as a joint obligation of each person who executes such contract. Miller v. Lewiston Nat'l Bank, 18 Idaho 124, 108 P. 901 (1910).

Liability of Indorser.

Unless otherwise indicated by appropriate words, one who puts his name to instrument, otherwise than as a maker, drawer or acceptor, was liable as indorser, and it was immaterial whether he signed before or after delivery. Thomas v. Hoebel, 46 Idaho 744, 271 P. 931 (1928).

Official Comment Section 3-114 replaces subsections (b) and (c) of former Section 3-118.

§ 28-3-115. Incomplete instrument. — (1) "Incomplete instrument" means a signed writing, whether or not issued by the signer, the contents of which show at the time of signing that it is incomplete but that the signer intended it to be completed by the addition of words or numbers.

(2) Subject to subsection (3) of this section, if an incomplete instrument is an instrument under section 28-3-104[, Idaho Code,] it may be enforced according to its terms if it is not completed, or according to its terms as augmented by completion. If an incomplete instrument is not an instrument under section 28-3-104[, Idaho Code,] but, after completion, the requirements of section 28-3-104[, Idaho Code,] are met, the instrument may be enforced according to its terms as augmented by completion.

(3) If words or numbers are added to an incomplete instrument without authority of the signer, there is an alteration of the incomplete instrument under section 28-3-407[, Idaho Code].

(4) The burden of establishing that words or numbers were added to an incomplete instrument without authority of the signer is on the person asserting the lack of authority.

History.

I.C., § 28-3-115, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-115 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (2) and (3) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Blank Wrongfully Filled.

Payee who took note for past due indebtedness, in which a blank had been wrongfully filled out, was not a holder in due course. Consolidated Wagon & Co. v. Housman, 38 Idaho 343, 221 P. 143 (1923).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 99 et seq.

Official Comment

1. This section generally carries forward the rules set out in former Section 3-115. The term "incomplete instrument" applies both to an "instrument," *i.e.* a writing meeting all the requirements of Section 3-104, and to a writing intended to be an instrument that is signed but lacks some element of an instrument. The test in both cases is whether the contents show that it is incomplete and that the signer intended that additional words or numbers be added.

2. If an incomplete instrument meets the requirements of Section 3-104 and is not completed it may be enforced in accordance with its terms. Suppose, in the following two cases, that a note delivered to the payee is incomplete solely because a space on the pre-printed note form for the due date is not filled in:

> **Case #1.** If the incomplete instrument is never completed, the note is payable on demand. Section 3-108(a)(ii). However, if the payee and the maker agreed to a due date, the maker may have a defense under Section 3-117 if demand for payment is made before the due date agreed to by the parties.
>
> **Case #2.** If the payee completes the note by filling in the due date agreed to by the parties, the note is payable on the due date stated. However, if the due date filled in was not the date agreed to by the parties there is an alteration of the note. Section 3-407 governs the case.

Suppose Debtor pays Creditor by giving Creditor a check on which the space for the name of the payee is left blank. The check is an instrument but

it is incomplete. The check is enforceable in its incomplete form and it is payable to bearer because it does not state a payee. Section 3-109(a)(2). Thus, Creditor is a holder of the check. Normally in this kind of case Creditor would simply fill in the space with Creditor's name. When that occurs the check becomes payable to the Creditor.

3. In some cases the incomplete instrument does not meet the requirements of Section 3-104. An example is a check with the amount not filled in. The check cannot be enforced until the amount is filled in. If the payee fills in an amount authorized by the drawer the check meets the requirements of Section 3-104 and is enforceable as completed. If the payee fills in an unauthorized amount there is an alteration of the check and Section 3-407 applies.

4. Section 3-302(a)(1) also bears on the problem of incomplete instruments. Under that section a person cannot be a holder in due course of the instrument if it is so incomplete as to call into question its validity. Subsection (d) of Section 3-115 is based on the last clause of subsection (2) of former Section 3-115.

§ 28-3-116. Joint and several liability — Contribution. — (1) Except as otherwise provided in the instrument, two (2) or more persons who have the same liability on an instrument as makers, drawers, acceptors, indorsers who indorse as joint payees, or anomalous indorsers are jointly and severally liable in the capacity in which they sign.

(2) Except as provided in section 28-3-419(5)[, Idaho Code,] or by agreement of the affected parties, a party having joint and several liability who pays the instrument is entitled to receive from any party having the same joint and several liability contribution in accordance with applicable law.

(3) Discharge of one (1) party having joint and several liability by a person entitled to enforce the instrument does not affect the right under subsection (2) of this section of a party having the same joint and several liability to receive contribution from the party discharged.

History.

I.C., § 28-3-116, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-116 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in subsection (2) was added by the compiler to conform to the statutory citation style.

CASE NOTES

Liability.

No accounting of other partnership accounts was necessary before the trial court acted on a partner's claim to recover debts against the debtor since he became liable for contribution to any of the other makers of the note who paid part of the debtor's share; that liability was not intertwined

with other partnership transactions. Berry v. Ostrom, 144 Idaho 458, 163 P.3d 247 (Ct. App. 2007).

Official Comment 1. Subsection (a) replaces subsection (e) of former Section 3-118. Subsection (b) states contribution rights of parties with joint and several liability by referring to applicable law. But subsection (b) is subject to Section 3-419(e). If one of the parties with joint and several liability is an accommodation party and the other is the accommodated party, Section 3-419(e) applies. Subsection (c) deals with discharge. The discharge of a jointly and severally liable obligor does not affect the right of other obligors to seek contribution from the discharged obligor.

2. Indorsers normally do not have joint and several liability. Rather, an earlier indorser has liability to a later indorser. But indorsers can have joint and several liability in two cases. If an instrument is payable to two payees jointly, both payees must indorse. The indorsement is a joint indorsement and the indorsers have joint and several liability and subsection (b) applies. The other case is that of two or more anomalous indorsers. The term is defined in Section 3-205(d). An anomalous indorsement normally indicates that the indorser signed as an accommodation party. If more than one accommodation party indorses a note as an accommodation to the maker, the indorsers have joint and several liability and subsection (b) applies.

§ 28-3-117. Other agreements affecting instrument. — Subject to applicable law regarding exclusion of proof of contemporaneous or previous agreements, the obligation of a party to an instrument to pay the instrument may be modified, supplemented or nullified by a separate agreement of the obligor and a person entitled to enforce the instrument, if the instrument is issued or the obligation is incurred in reliance on the agreement or as part of the same transaction giving rise to the agreement. To the extent an obligation is modified, supplemented or nullified by an agreement under this section, the agreement is a defense to the obligation.

History.

I.C., § 28-3-117, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-117 was repealed. See Prior Laws, § 28-3-101.

Official Comment 1. The separate agreement might be a security agreement or mortgage or it might be an agreement that contradicts the terms of the instrument. For example, a person may be induced to sign an instrument under an agreement that the signer will not be liable on the instrument unless certain conditions are met. Suppose X requested credit from Creditor who is willing to give the credit only if an acceptable accommodation party will sign the note of X as co-maker. Y agrees to sign as co-maker on the condition that Creditor also obtain the signature of Z as co-maker. Creditor agrees and Y signs as co-maker with X. Creditor fails to obtain the signature of Z on the note. Under Sections 3-412 and 3-419(b), Y is obliged to pay the note, but Section 3-117 applies. In this case, the agreement modifies the terms of the note by stating a condition to the obligation of Y to pay the note. This case is essentially similar to a case in which a maker of a note is induced to sign the note by fraud of the holder. Although the agreement that Y not be liable on the note unless Z also signs may not have been

fraudulently made, a subsequent attempt by Creditor to require Y to pay the note in violation of the agreement is a bad faith act. Section 3-117, in treating the agreement as a defense, allows Y to assert the agreement against Creditor, but the defense would not be good against a subsequent holder in due course of the note that took it without notice of the agreement. If there cannot be a holder in due course because of Section 3-106(d), a subsequent holder that took the note in good faith, for value and without knowledge of the agreement would not be able to enforce the liability of Y. This result is consistent with the risk that a holder not in due course takes with respect to fraud in inducing issuance of an instrument.

2. The effect of merger or integration clauses to the effect that a writing is intended to be the complete and exclusive statement of the terms of the agreement or that the agreement is not subject to conditions is left to the supplementary law of the jurisdiction pursuant to Section 1-103. Thus, in the case discussed in Comment 1, whether Y is permitted to prove the condition to Y's obligation to pay the note is determined by that law. Moreover, nothing in this section is intended to validate an agreement which is fraudulent or void as against public policy, as in the case of a note given to deceive a bank examiner.

§ 28-3-118. Statute of limitations. — (1) Except as provided in subsection (5) of this section, an action to enforce the obligation of a party to pay a note payable at a definite time must be commenced within six (6) years after the due date or dates stated in the note or, if a due date is accelerated, within six (6) years after the accelerated due date.

(2) Except as provided in subsection (4) or (5) of this section, if demand for payment is made to the maker of a note payable on demand, an action to enforce the obligation of a party to pay the note must be commenced within six (6) years after the demand. If no demand for payment is made to the maker, an action to enforce the note is barred if neither principal nor interest on the note has been paid for a continuous period of ten (10) years.

(3) Except as provided in subsection (4) of this section, an action to enforce the obligation of a party to an unaccepted draft to pay the draft must be commenced within three (3) years after dishonor of the draft or ten (10) years after the date of the draft, whichever period expires first.

(4) An action to enforce the obligation of the acceptor of a certified check or the issuer of a teller's check, cashier's check, or traveler's check must be commenced within three (3) years after demand for payment is made to the acceptor or issuer, as the case may be.

(5) An action to enforce the obligation of a party to a certificate of deposit to pay the instrument must be commenced within six (6) years after demand for payment is made to the maker, but if the instrument states a due date and the maker is not required to pay before that date, the six (6) year period begins when a demand for payment is in effect and the due date has passed.

(6) An action to enforce the obligation of a party to pay an accepted draft, other than a certified check, must be commenced (i) within six (6) years after the due date or dates stated in the draft or acceptance if the obligation of the acceptor is payable at a definite time, or (ii) within six (6) years after the date of the acceptance if the obligation of the acceptor is payable on demand.

(7) Unless governed by other law regarding claims for indemnity or contribution, an action (i) for conversion of an instrument, for money had and received, or like action based on conversion, (ii) for breach of warranty, or (iii) to enforce an obligation, duty or right arising under this chapter and not governed by this section must be commenced within three (3) years after the cause of action accrues.

History.

I.C., § 28-3-118, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-118 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Applicability.

Where a former client's disability checks were alleged to have been cashed and spent by the law firm which received the checks, the cause of action was not subject to the statute of limitations for legal malpractice under § 5-219(4), or the statute of limitations for fraud under § 5-218(4). It was an action for conversion under subsection (7) of this section; however, under any of these sections, the limitations period had run before plaintiff filed suit. McCormack v. Caldwell, 152 Idaho 15, 266 P.3d 490 (Ct. App. 2011).

Conversion.

Where a former client alleged that his disability checks were erroneously sent to his attorney's and that the attorney or a member of his office forged the client's name, cashed the checks, and retained the funds instead of forwarding the checks to the client, and the client then filed a legal malpractice claim against the attorney, the cause of action was not subject to the two-year statute of limitations under § 5-219(4). Despite the label

attached to the claim, the claim was actually one for conversion of instruments and was, thus, subject to the three-year statute of limitations under subsection (7). McCormack v. Caldwell, 152 Idaho 15, 266 P.3d 490 (Ct. App. 2011).

Official Comment

1. Section 3-118 differs from former Section 3-122, which states when a cause of action accrues on an instrument. Section 3-118 does not define when a cause of action accrues. Accrual of a cause of action is stated in other sections of Article 3 such as those that state the various obligations of parties to an instrument. The only purpose of Section 3-118 is to define the time within which an action to enforce an obligation, duty, or right arising under Article 3 must be commenced. Section 3-118 does not attempt to state all rules with respect to a statute of limitations. For example, the circumstances under which the running of a limitations period may be tolled is left to other law pursuant to Section 1-103.

2. The first six subsections apply to actions to enforce an obligation of any party to an instrument to pay the instrument. This changes present law in that indorsers who may become liable on an instrument after issue are subject to a period of limitations running from the same date as that of the maker or drawer. Subsections (a) and (b) apply to notes. If the note is payable at a definite time, a six-year limitations period starts at the due date of the note, subject to prior acceleration. If the note is payable on demand, there are two limitations periods. Although a note payable on demand could theoretically be called a day after it was issued, the normal expectation of the parties is that the note will remain outstanding until there is some reason to call it. If the law provides that the limitations period does not start until demand is made, the cause of action to enforce it may never be barred. On the other hand, if the limitations period starts when demand for payment may be made, *i.e.* at any time after the note was issued, the payee of a note on which interest or portions of principal are being paid could lose the right to enforce the note even though it was treated as a continuing obligation by the parties. Some demand notes are not enforced because the payee has forgiven the debt. This is particularly true in family and other noncommercial transactions. A demand note found after the death of the payee may be presented for payment many years after it was issued. The

maker may be a relative and it may be difficult to determine whether the note represents a real or a forgiven debt. Subsection (b) is designed to bar notes that no longer represent a claim to payment and to require reasonably prompt action to enforce notes on which there is default. If a demand for payment is made to the maker, a six-year limitations period starts to run when demand is made. The second sentence of subsection (b) bars an action to enforce a demand note if no demand has been made on the note and no payment of interest or principal has been made for a continuous period of 10 years. This covers the case of a note that does not bear interest or a case in which interest due on the note has not been paid. This kind of case is likely to be a family transaction in which a failure to demand payment may indicate that the holder did not intend to enforce the obligation but neglected to destroy the note. A limitations period that bars stale claims in this kind of case is appropriate if the period is relatively long.

3. Subsection (c) applies primarily to personal uncertified checks. Checks are payment instruments rather than credit instruments. The limitations period expires three years after the date of dishonor or 10 years after the date of the check, whichever is earlier. Teller's checks, cashier's checks, certified checks, and traveler's checks are treated differently under subsection (d) because they are commonly treated as cash equivalents. A great delay in presenting a cashier's check for payment in most cases will occur because the check was mislaid during that period. The person to whom traveler's checks are issued may hold them indefinitely as a safe form of cash for use in an emergency. There is no compelling reason for barring the claim of the owner of the cashier's check or traveler's check. Under subsection (d) the claim is never barred because the three-year limitations period does not start to run until demand for payment is made. The limitations period in subsection (d) in effect applies only to cases in which there is a dispute about the legitimacy of the claim of the person demanding payment.

4. Subsection (e) covers certificates of deposit. The limitations period of six years doesn't start to run until the depositor demands payment. Most certificates of deposit are payable on demand even if they state a due date. The effect of a demand for payment before maturity is usually that the bank will pay, but that a penalty will be assessed against the depositor in the form of a reduction in the amount of interest that is paid. Subsection (e) also

provides for cases in which the bank has no obligation to pay until the due date. In that case the limitations period doesn't start to run until there is a demand for payment in effect and the due date has passed.

5. Subsection (f) applies to accepted drafts other than certified checks. When a draft is accepted it is in effect turned into a note of the acceptor. In almost all cases the acceptor will agree to pay at a definite time. Subsection (f) states that in that case the six-year limitations period starts to run on the due date. In the rare case in which the obligation of the acceptor is payable on demand, the six-year limitations period starts to run at the date of the acceptance.

6. Subsection (g) covers warranty and conversion cases and other actions to enforce obligations or rights arising under Article 3. A three-year period is stated and subsection (g) follows general law in stating that the period runs from the time the cause of action accrues. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

7. One of the most significant differences between this Article and the Convention on International Bills of Exchange and International Promissory Notes is that the statute of limitation under the Convention generally is only four years, rather than the six years provided by this section. See Convention Article 84.

§ 28-3-119. Notice of right to defend action. — In an action for breach of an obligation for which a third person is answerable over pursuant to this chapter or chapter 4[, title 28, Idaho Code], the defendant may give the third person written notice of the litigation, and the person notified may then give similar notice to any other person who is answerable over. If the notice states (i) that the person notified may come in and defend and (ii) that failure to do so will bind the person notified in an action later brought by the person giving the notice as to any determination of fact common to the two (2) litigations, the person notified is so bound unless after seasonable receipt of the notice the person notified does come in and defend.

History.

I.C., § 28-3-119, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-119 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in the first sentence was added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 577 et seq.

67A Am. Jur. 2d, Sales, § 1109 et seq.

Official Comment

This section is a restatement of former Section 3-803.

§ 28-3-120 — 28-3-122. Instruments "payable through" bank — Instruments payable at bank — Accrual of cause of action [Repealed.]

STATUTORY NOTES

Prior Laws.

Former §§ 28-3-120 to 28-3-122 were repealed. See Prior Laws, § 28-3-101.

Part 2
Negotiation, Transfer, And Indorsement

Idaho Code § 28-3-201

§ 28-3-201. Negotiation. — (1) "Negotiation" means a transfer of possession, whether voluntary or involuntary, of an instrument by a person other than the issuer to a person who thereby becomes its holder.

(2) Except for negotiation by a remitter, if an instrument is payable to an identified person, negotiation requires transfer of possession of the instrument and its indorsement by the holder. If an instrument is payable to bearer, it may be negotiated by transfer of possession alone.

History.

I.C., § 28-3-201, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-201 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

Delivery.

Contingent and conditional delivery was a defense to an instrument in the hands of a holder not a holder in due course. Whittlesey v. Drake, 43 Idaho 623, 253 P. 621 (1927).

Effect of Transfer Without Indorsement.

Where holder of note transferred it without indorsement, transferee took such title as transferor had, subject to any defenses existing in maker. Sanderson v. Clark, 33 Idaho 359, 194 P. 472 (1920).

Failure of Consideration.

Want or failure of consideration was a good defense against a holder not in due course. Shellenberger v. Nourse, 20 Idaho 323, 118 P. 508 (1911); Whittlesey v. Drake, 43 Idaho 623, 253 P. 621 (1927).

Fraud.

Fraud was available as a defense against a holder not in due course. Shellenberger v. Nourse, 20 Idaho 323, 118 P. 508 (1911).

Guaranty as Indorsement.

A written guaranty on the back of a note signed by the payee, passed the title the same as would an indorsement in blank. Hutson v. Rankin, 36 Idaho 169, 213 P. 345 (1922).

Illegal Consideration.

Total or partial illegality of consideration was a defense against a holder not in due course. Ashley State Bank v. Hood, 47 Idaho 780, 279 P. 418 (1929).

Indorsement by Agent.

The fact that agent had indorsed in blank checks payable to principal when depositing them in the principal's bank account did not indicate what form of indorsement was necessary to allow him to carry out his express authority in said account. Coeur d'Alene Mining Co. v. First Nat'l Bank, 118 Idaho 812, 800 P.2d 1026 (1990).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 177 et seq.

C.J.S. — 10 C.J.S., Bills and Notes, § 158 et seq.

Official Comment

1. Subsections (a) and (b) are based in part on subsection (1) of former Section 3-202. A person can become holder of an instrument when the instrument is issued to that person, or the status of holder can arise as the result of an event that occurs after issuance. "Negotiation" is the term used in Article 3 to describe this post-issuance event. Normally, negotiation occurs as the result of a voluntary transfer of possession of an instrument by a holder to another person who becomes the holder as a result of the transfer. Negotiation always requires a change in possession of the instrument because nobody can be a holder without possessing the instrument, either directly or through an agent. But in some cases the transfer of possession is involuntary and in some cases the person transferring possession is not a holder. In defining "negotiation" former Section 3-202(1) used the word "transfer," an undefined term, and "delivery," defined in Section 1-201(14) to mean voluntary change of possession. Instead, subsections (a) and (b) use the term "transfer of possession" and, subsection (a) states that negotiation can occur by an involuntary transfer of possession. For example, if an instrument is payable to bearer and it is stolen by Thief or is found by Finder, Thief or Finder becomes the holder of the instrument when possession is obtained. In this case there is an involuntary transfer of possession that results in negotiation to Thief or Finder.

2. In most cases negotiation occurs by a transfer of possession by a holder or remitter. Remitter transactions usually involve a cashier's or teller's check. For example, Buyer buys goods from Seller and pays for them with a cashier's check of Bank that Buyer buys from Bank. The check is issued by Bank when it is delivered to Buyer, regardless of whether the check is payable to Buyer or to Seller. Section 3-105(a). If the check is payable to Buyer, negotiation to Seller is done by delivery of the check to Seller after it is indorsed by Buyer. It is more common, however, that the check when issued will be payable to Seller. In that case Buyer is referred to as the "remitter." Section 3-103(a)(11). The remitter, although not a party to the check, is the owner of the check until ownership is transferred to Seller by delivery. This transfer is a negotiation because Seller becomes the holder

of the check when Seller obtains possession. In some cases Seller may have acted fraudulently in obtaining possession of the check. In those cases Buyer may be entitled to rescind the transfer to Seller because of the fraud and assert a claim of ownership to the check under Section 3-306 against Seller or a subsequent transferee of the check. Section 3-202(b) provides for rescission of negotiation, and that provision applies to rescission by a remitter as well as by a holder.

3. Other sections of Article 3 may modify the rule stated in the first sentence of subsection (b). See for example, Sections 3-404, 3-405, and 3-406.

§ 28-3-202. Negotiation subject to rescission. — (1) Negotiation is effective even if obtained (i) from an infant, a corporation exceeding its powers, or a person without capacity, (ii) by fraud, duress or mistake, or (iii) in breach of duty or as part of an illegal transaction.

(2) To the extent permitted by other law, negotiation may be rescinded or may be subject to other remedies, but those remedies may not be asserted against a subsequent holder in due course or a person paying the instrument in good faith and without knowledge of facts that are a basis for rescission or other remedy.

History.

I.C., § 28-3-202, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-202 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

Burden of Proof.

Where defendant pleads and proves that note was procured by fraud, it was incumbent upon plaintiff to show affirmatively that he was a holder in due course. Winter v. Nobs, 19 Idaho 18, 112 P. 525 (1910).

Where it was shown that original instrument was obtained by fraud, burden rests upon subsequent holder to prove that he acquired title as holder in due course and that he took instrument in good faith and for value, with no notice of defect in title. Guthrie v. Ensign, 36 Idaho 673, 213 P. 354 (1923).

Where evidence showed conditional delivery of promissory note, burden was on holder to show that he took without notice of such defect. First Nat'l Bank v. Campbell, 39 Idaho 736, 230 P. 43 (1924).

Proof that consideration for note was securities issued in violation of Blue Sky Law and, therefore, illegal shifted the burden to the holder to show that he was an owner in due course. Ashley & Rumelin v. Brady, 41 Idaho 160, 238 P. 314 (1925).

Title to note being defective, plaintiff had burden of proving that he was holder in due course. Ashley State Bank v. Hood, 47 Idaho 780, 279 P. 418 (1929).

Proof of noncompliance was admissible and cast on the holder the duty of showing that he was a holder in due course. Continental Nat'l Bank v. Cole, 51 Idaho 140, 3 P.2d 1103 (1931).

Delivery.

Contingent or conditional delivery was a defense to an instrument in the hands of a holder not in due course. Whittlesey v. Drake, 43 Idaho 623, 253 P. 621 (1927).

Failure of Consideration.

Want or failure of consideration was a good defense against a holder not a holder in due course. Shellenberger v. Nourse, 20 Idaho 323, 118 P. 508 (1911).

Fraud.

Fraud was available as a defense against a holder not in due course. Shellenberger v. Nourse, 20 Idaho 328, 118 P. 508 (1911).

Illegal Consideration.

Total or partial illegality of consideration was a defense against a holder not in due course. Ashley State Bank v. Hood, 47 Idaho 780, 279 P. 418 (1929).

Notice.

Transferee of note, regular on its face, need not inquire whether payee had complied with state laws, unless he had notice of facts putting him on inquiry. Chesney v. Bodily, 50 Idaho 597, 298 P. 937 (1931).

Pleading and Practice.

Where defendant denied that plaintiff was a bona fide holder of a note, but offered no evidence to substantiate his denial, and the evidence of the plaintiff tended to prove that men of ordinary intelligence might draw different conclusions from such evidence, the court might have refused to instruct a verdict for the plaintiff. Winter v. Hutchins, 20 Idaho 749, 119 P. 883 (1911).

Where no defense was alleged, the sufficiency of the pleading as to bona fides of the holder was immaterial. Colorado Nat'l Bank v. Meadow Creek Livestock Co., 36 Idaho 509, 211 P. 1076 (1922).

There need be no allegation charging the holder of a note with notice of defects in order to prevent evidence of such facts to be introduced. Chesney v. Bodily, 50 Idaho 597, 298 P. 937 (1931).

Presumptions.

Evidence must be sufficient to show that title of indorser of instrument was defective, so as to remove presumption that every holder was deemed prima facie to be a holder in due course. Pacific States Automotive Fin. Corp. v. Addison, 45 Idaho 270, 261 P. 683 (1927).

One suing on trade acceptance was presumed to be holder in due course. Harris v. Sainsbury, 50 Idaho 502, 298 P. 360 (1931).

Weight of Evidence for Jury.

Whether plaintiff had satisfactorily met burden of proof to make good his claim to be innocent purchaser was a question of fact for the jury and was subject to the same rule as to its weight and sufficiency as any other fact in the case (*Winter v. Nobs*, 19 Idaho 18, 112 P. 525 (1910)), save where testimony was not only consistent with good faith of purchase, but was such that no fair-minded person could draw any other inference therefrom. Southwest Nat'l Bank v. Lindsley, 29 Idaho 343, 158 P. 1082 (1916).

Where evidence was conflicting and different inferences might have been drawn therefrom, question whether plaintiff was a holder in due course was one for the jury, provided evidence was sufficient to warrant submission of question to jury. GMAC v. Talbott, 39 Idaho 707, 230 P. 30 (1924).

Verdict may be directed, even where only testimony relied on by holder of note was his own or his agent's, if they were unimpeached, uncontradicted and no contrary inference could be drawn from facts and circumstances shown by the evidence. First Nat'l Bank v. Pond, 39 Idaho 770, 230 P. 344 (1924).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 192.

Official Comment

1. This section is based on former Section 3-207. Subsection (2) of former Section 3-207 prohibited rescission of a negotiation against holders in due course. Subsection (b) of Section 3-202 extends this protection to payor banks.

2. Subsection (a) applies even though the lack of capacity or the illegality, is of a character which goes to the essence of the transaction and makes it entirely void. It is inherent in the character of negotiable instruments that any person in possession of an instrument which by its terms is payable to that person or to bearer is a holder and may be dealt with by anyone as a holder. The principle finds its most extreme application in the well settled rule that a holder in due course may take the instrument even from a thief and be protected against the claim of the rightful owner. The policy of subsection (a) is that any person to whom an instrument is

negotiated is a holder until the instrument has been recovered from that person's possession. The remedy of a person with a claim to an instrument is to recover the instrument by replevin or otherwise; to impound it or to enjoin its enforcement, collection or negotiation; to recover its proceeds from the holder; or to intervene in any action brought by the holder against the obligor. As provided in Section 3-305(c), the claim of the claimant is not a defense to the obligor unless the claimant defends the action.

3. There can be no rescission or other remedy against a holder in due course or a person who pays in good faith and without notice, even though the prior negotiation may have been fraudulent or illegal in its essence and entirely void. As against any other party the claimant may have any remedy permitted by law. This section is not intended to specify what that remedy may be, or to prevent any court from imposing conditions or limitations such as prompt action or return of the consideration received. All such questions are left to the law of the particular jurisdiction. Section 3-202 gives no right that would not otherwise exist. The section is intended to mean that any remedies afforded by other law are cut off only by a holder in due course.

§ 28-3-203. Transfer of instrument — Rights acquired by transfer. —

(1) An instrument is transferred when it is delivered by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument.

(2) Transfer of an instrument, whether or not the transfer is a negotiation, vests in the transferee any right of the transferor to enforce the instrument, including any right as a holder in due course, but the transferee cannot acquire rights of a holder in due course by a transfer, directly or indirectly, from a holder in due course if the transferee engaged in fraud or illegality affecting the instrument.

(3) Unless otherwise agreed, if an instrument is transferred for value and the transferee does not become a holder because of lack of indorsement by the transferor, the transferee has a specifically enforceable right to the unqualified indorsement of the transferor, but negotiation of the instrument does not occur until the indorsement is made.

(4) If a transferor purports to transfer less than the entire instrument, negotiation of the instrument does not occur. The transferee obtains no rights under this chapter and has only the rights of a partial assignee.

History.

I.C., § 28-3-203, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-203 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Holder.

To be the “holder” of a promissory note, one must possess the note and the note must be payable to the person in possession, or to bearer. If the note is not payable to the person in possession or is not indorsed, either in

blank or specifically to the person in possession, then that person must show evidence of being a non-"holder" in possession with a right to enforce, including proof of the transaction by which he acquired the note. In re Wilhelm, 407 B.R. 392 (Bankr. D. Idaho 2009).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 177 et seq.

C.J.S. — 10 C.J.S., Bills and Notes, § 170 et seq.

Official Comment

1. Section 3-203 is based on former Section 3-201 which stated that a transferee received such rights as the transferor had. The former section was confusing because some rights of the transferor are not vested in the transferee unless the transfer is a negotiation. For example, a transferee that did not become the holder could not negotiate the instrument, a right that the transferor had. Former Section 3-201 did not define "transfer." Subsection (a) defines transfer by limiting it to cases in which possession of the instrument is delivered for the purpose of giving to the person receiving delivery the right to enforce the instrument.

Although transfer of an instrument might mean in a particular case that title to the instrument passes to the transferee, that result does not follow in all cases. The right to enforce an instrument and ownership of the instrument are two different concepts. A thief who steals a check payable to bearer becomes the holder of the check and a person entitled to enforce it, but does not become the owner of the check. If the thief transfers the check to a purchaser the transferee obtains the right to enforce the check. If the purchaser is not a holder in due course, the owner's claim to the check may be asserted against the purchaser. Ownership rights in instruments may be determined by principles of the law of property, independent of Article 3, which do not depend upon whether the instrument was transferred under Section 3-203. Moreover, a person who has an ownership right in an instrument might not be a person entitled to enforce the instrument. For example, suppose X is the owner and holder of an instrument payable to X. X sells the instrument to Y but is unable to deliver immediate possession to Y. Instead, X signs a document conveying all of X's right, title, and interest

in the instrument to Y. Although the document may be effective to give Y a claim to ownership of the instrument, Y is not a person entitled to enforce the instrument until Y obtains possession of the instrument. No transfer of the instrument occurs under Section 3-203(a) until it is delivered to Y.

An instrument is a reified right to payment. The right is represented by the instrument itself. The right to payment is transferred by delivery of possession of the instrument "by a person other than its issuer for the purpose of giving to the person receiving delivery the right to enforce the instrument." The quoted phrase excludes issue of an instrument, defined in Section 3-105, and cases in which a delivery of possession is for some purpose other than transfer of the right to enforce. For example, if a check is presented for payment by delivering the check to the drawee, no transfer of the check to the drawee occurs because there is no intent to give the drawee the right to enforce the check.

2. Subsection (b) states that transfer vests in the transferee any right of the transferor to enforce the instrument "including any rights as a holder in due course." If the transferee is not a holder because the transferor did not indorse, the transferee is nevertheless a person entitled to enforce the instrument under Section 3-301 if the transferor was a holder at the time of transfer. Although the transferee is not a holder, under subsection (b) the transferee obtained the rights of the transferor as holder. Because the transferee's rights are derivative of the transferor's rights, those rights must be proved. Because the transferee is not a holder, there is no presumption under Section 3-308 that the transferee, by producing the instrument, is entitled to payment. The instrument, by its terms, is not payable to the transferee and the transferee must account for possession of the unindorsed instrument by proving the transaction through which the transferee acquired it. Proof of a transfer to the transferee by a holder is proof that the transferee has acquired the rights of a holder. At that point the transferee is entitled to the presumption under Section 3-308.

Under subsection (b) a holder in due course that transfers an instrument transfers those rights as a holder in due course to the purchaser. The policy is to assure the holder in due course a free market for the instrument. There is one exception to this rule stated in the concluding clause of subsection (b). A person who is party to fraud or illegality affecting the instrument is

not permitted to wash the instrument clean by passing it into the hands of a holder in due course and then repurchasing it.

3. Subsection (c) applies only to a transfer for value. It applies only if the instrument is payable to order or specially indorsed to the transferor. The transferee acquires, in the absence of a contrary agreement, the specifically enforceable right to the indorsement of the transferor. Unless otherwise agreed, it is a right to the general indorsement of the transferor with full liability as indorser, rather than to an indorsement without recourse. The question may arise if the transferee has paid in advance and the indorsement is omitted fraudulently or through oversight. A transferor who is willing to indorse only without recourse or unwilling to indorse at all should make those intentions clear before transfer. The agreement of the transferee to take less than an unqualified indorsement need not be an express one, and the understanding may be implied from conduct, from past practice, or from the circumstances of the transaction. Subsection (c) provides that there is no negotiation of the instrument until the indorsement by the transferor is made. Until that time the transferee does not become a holder, and if earlier notice of a defense or claim is received, the transferee does not qualify as a holder in due course under Section 3-302.

4. The operation of Section 3-203 is illustrated by the following cases. In each case Payee, by fraud, induced Maker to issue a note to Payee. The fraud is a defense to the obligation of Maker to pay the note under Section 3-305(a)(2).

> **Case #1.** Payee negotiated the note to X who took as a holder in due course. After the instrument became overdue X negotiated the note to Y who had notice of the fraud. Y succeeds to X's rights as a holder in due course and takes free of Maker's defense of fraud.
>
> **Case #2.** Payee negotiated the note to X who took as a holder in due course. Payee then repurchased the note from X. Payee does not succeed to X's rights as a holder in due course and is subject to Maker's defense of fraud.
>
> **Case #3.** Payee negotiated the note to X who took as a holder in due course. X sold the note to Purchaser who received possession. The note, however, was indorsed to X and X failed to indorse it. Purchaser is a person entitled to enforce the instrument under Section 3-301 and

succeeds to the rights of X as holder in due course. Purchaser is not a holder, however, and under Section 3-308 Purchaser will have to prove the transaction with X under which the rights of X as holder in due course were acquired.

Case #4. Payee sold the note to Purchaser who took for value, in good faith and without notice of the defense of Maker. Purchaser received possession of the note but Payee neglected to indorse it. Purchaser became a person entitled to enforce the instrument but did not become the holder because of the missing indorsement. If Purchaser received notice of the defense of Maker before obtaining the indorsement of Payee, Purchaser cannot become a holder in due course because at the time notice was received the note had not been negotiated to Purchaser. If indorsement by Payee was made after Purchaser received notice, Purchaser had notice of the defense when it became the holder.

5. Subsection (d) restates former Section 3-202(3). The cause of action on an instrument cannot be split. Any indorsement which purports to convey to any party less than the entire amount of the instrument is not effective for negotiation. This is true of either "Pay A one-half," or "Pay A two-thirds and B one-third." Neither A nor B becomes a holder. On the other hand an indorsement reading merely "Pay A and B" is effective, since it transfers the entire cause of action to A and B as tenants in common. An indorsement purporting to convey less than the entire instrument does, however, operate as a partial assignment of the cause of action. Subsection (d) makes no attempt to state the legal effect of such an assignment, which is left to other law. A partial assignee of an instrument has rights only to the extent the applicable law gives rights, either at law or in equity, to a partial assignee.

6. The rules for transferring instruments set out in this section are similar to the rules in Article 13 of the Convention on International Bills of Exchange and International Promissory Notes.

§ 28-3-204. Indorsement. — (1) "Indorsement" means a signature, other than that of a signer as maker, drawer or acceptor, that alone or accompanied by other words is made on an instrument for the purpose of (i) negotiating the instrument, (ii) restricting payment of the instrument, or (iii) incurring indorser's liability on the instrument, but regardless of the intent of the signer, a signature and its accompanying words is an indorsement unless the accompanying words, terms of the instrument, place of the signature, or other circumstances unambiguously indicate that the signature was made for a purpose other than indorsement. For the purpose of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument.

(2) "Indorser" means a person who makes an indorsement.

(3) For the purpose of determining whether the transferee of an instrument is a holder, an indorsement that transfers a security interest in the instrument is effective as an unqualified indorsement of the instrument.

(4) If an instrument is payable to a holder under a name that is not the name of the holder, indorsement may be made by the holder in the name stated in the instrument or in the holder's name or both, but signature in both names may be required by a person paying or taking the instrument for value or collection.

History.

I.C., § 28-3-204, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-204 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Cited State v. Allen, 148 Idaho 578, 225 P.3d 1173 (Ct. App. 2009).

Decisions Under Prior Law

Assignment.

The majority of the courts took the view that the liability of an ordinary indorser was imposed upon whoever makes an assignment upon the back of commercial paper. Bradford v. Sturman, 86 Idaho 178, 384 P.2d 64 (1963).

Without more, the use of the word "assign" was not sufficient to clearly indicate an intention to be bound in some other capacity than that of indorser. Bradford v. Sturman, 86 Idaho 178, 384 P.2d 64 (1963).

Contract of Guaranty.

Contract of guaranty indorsed upon a promissory note in the following words: "For value received I hereby guaranty the payment of the within note and waive protest, demand and notice of nonpayment thereof," was a several as well as a joint obligation of each person who executed such contract. Miller v. Lewiston Nat'l Bank, 18 Idaho 124, 108 P. 901 (1910).

Indorser Defined.

One who simply wrote his name on the back of a note without any qualification or limitation was an indorser and liable as such under former law. Jeppesen v. Rexburg State Bank, 57 Idaho 94, 62 P.2d 1369 (1936).

Liability as Indorser.

Where defendant signed his name on the back of note prior to its delivery, without any indication of his intention to be bound otherwise, he was held to be an indorser. Bank of Montpelier v. Montpelier Lumber Co., 16 Idaho 730, 102 P. 685 (1909).

Unless indicated otherwise by appropriate words, one who puts his name to an instrument, otherwise than as maker, drawer or acceptor, was liable as indorser, and it was immaterial whether he signed before or after delivery. Thomas v. Hoebel, 46 Idaho 744, 271 P. 931 (1928).

Signature of Maker.

The location of the signatures on the notes in the lower right hand corner clearly indicates that the signatures were made in the capacity of makers. Ritzau v. Warm Springs W., 589 F.2d 1370 (9th Cir. 1979).

Signing in Blank.

Signing in blank after as well as before delivery made the signer an indorser. Thomas v. Hoebel, 46 Idaho 744, 271 P. 931 (1928).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 193 et seq.

Official Comment

1. Subsection (a) is a definition of "indorsement," a term which was not defined in former Article 3. Indorsement is defined in terms of the purpose of the signature. If a blank or special indorsement is made to give rights as a holder to a transferee the indorsement is made for the purpose of negotiating the instrument. Subsection (a)(i). If the holder of a check has an account in the drawee bank and wants to be sure that payment of the check will be made by credit to the holder's account, the holder can indorse the check by signing the holder's name with the accompanying words "for deposit only" before presenting the check for payment to the drawee bank. In that case the purpose of the quoted words is to restrict payment of the instrument. Subsection (a)(ii). If X wants to guarantee payment of a note signed by Y as maker, X can do so by signing X's name to the back of the note as an indorsement. This indorsement is known as an anomalous indorsement (Section 3-205(d)) and is made for the purpose of incurring indorser's liability on the note. Subsection (a)(iii). In some cases an indorsement may serve more than one purpose. For example, if the holder of a check deposits it to the holder's account in a depositary bank for collection and indorses the check by signing the holder's name with the

accompanying words "for deposit only" the purpose of the indorsement is both to negotiate the check to the depositary bank and to restrict payment of the check.

The "but" clause of the first sentence of subsection (a) elaborates on former Section 3-402. In some cases it may not be clear whether a signature was meant to be that of an indorser, a party to the instrument in some other capacity such as drawer, maker or acceptor, or a person who was not signing as a party. The general rule is that a signature is an indorsement if the instrument does not indicate an unambiguous intent of the signer not to sign as an indorser. Intent may be determined by words accompanying the signature, the place of signature, or other circumstances. For example, suppose a depositary bank gives cash for a check properly indorsed by the payee. The bank requires the payee's employee to sign the back of the check as evidence that the employee received the cash. If the signature consists only of the initials of the employee it is not reasonable to assume that it was meant to be an indorsement. If there was a full signature but accompanying words indicated that it was meant as a receipt for the cash given for the check, it is not an indorsement. If the signature is not qualified in any way and appears in the place normally used for indorsements, it may be an indorsement even though the signer intended the signature to be a receipt. To take another example, suppose the drawee of a draft signs the draft on the back in the space usually used for indorsements. No words accompany the signature. Since the drawee has no reason to sign a draft unless the intent is to accept the draft, the signature is effective as an acceptance. Custom and usage may be used to determine intent. For example, by long-established custom and usage, a signature in the lower right hand corner of an instrument indicates an intent to sign as the maker of a note or the drawer of a draft. Any similar clear indication of an intent to sign in some other capacity or for some other purpose may establish that a signature is not an indorsement. For example, if the owner of a traveler's check countersigns the check in the process of negotiating it, the countersignature is not an indorsement. The countersignature is a condition to the issuer's obligation to pay and its purpose is to provide a means of verifying the identity of the person negotiating the traveler's check by allowing comparison of the specimen signature and the countersignature. The countersignature is not necessary for negotiation and the signer does not incur indorser's liability. See Comment 2 to Section 3-106.

The last sentence of subsection (a) is based on subsection (2) of former Section 3-202. An indorsement on an allonge is valid even though there is sufficient space on the instrument for an indorsement.

2. Assume that Payee indorses a note to Creditor as security for a debt. Under subsection (b) of Section 3-203 Creditor takes Payee's rights to enforce or transfer the instrument subject to the limitations imposed by Article 9. Subsection (c) of Section 3-204 makes clear that Payee's indorsement to Creditor, even though it mentions creation of a security interest, is an unqualified indorsement that gives to Creditor the right to enforce the note as its holder.

3. Subsection (d) is a restatement of former Section 3-203. Section 3-110(a) states that an instrument is payable to the person intended by the person signing as or in the name or behalf of the issuer even if that person is identified by a name that is not the true name of the person. In some cases the name used in the instrument is a misspelling of the correct name and in some cases the two names may be entirely different. The payee may indorse in the name used in the instrument, in the payee's correct name, or in both. In each case the indorsement is effective. But because an indorsement in a name different from that used in the instrument may raise a question about its validity and an indorsement in a name that is not the correct name of the payee may raise a problem of identifying the indorser, the accepted commercial practice is to indorse in both names. Subsection (d) allows a person paying or taking the instrument for value or collection to require indorsement in both names.

§ 28-3-205. Special indorsement — Blank indorsement — Anomalous indorsement. — (1) If an indorsement is made by the holder of an instrument, whether payable to an identified person or payable to bearer, and the indorsement identifies a person to whom it makes the instrument payable, it is a "special indorsement." When specially indorsed, an instrument becomes payable to the identified person and may be negotiated only by the indorsement of that person. The principles stated in section 28-3-110[, Idaho Code,] apply to special indorsements.

(2) If an indorsement is made by the holder of an instrument and it is not a special indorsement, it is a "blank indorsement." When indorsed in blank, an instrument becomes payable to bearer and may be negotiated by transfer of possession alone until specially indorsed.

(3) The holder may convert a blank indorsement that consists only of a signature into a special indorsement by writing, above the signature of the indorser, words identifying the person to whom the instrument is made payable.

(4) "Anomalous indorsement" means an indorsement made by a person who is not the holder of the instrument. An anomalous indorsement does not affect the manner in which the instrument may be negotiated.

History.

I.C., § 28-3-205, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-205 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in the last sentence in subsection (1) was added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 200 et seq.

Official Comment

1. Subsection (a) is based on subsection (1) of former Section 3-204. It states the test of a special indorsement to be whether the indorsement identifies a person to whom the instrument is payable. Section 3-110 states rules for identifying the payee of an instrument. Section 3-205(a) incorporates the principles stated in Section 3-110 in identifying an indorsee. The language of Section 3-110 refers to language used by the issuer of the instrument. When that section is used with respect to an indorsement, Section 3-110 must be read as referring to the language used by the indorser.

2. Subsection (b) is based on subsection (2) of former Section 3-204. An indorsement made by the holder is either a special or blank indorsement. If the indorsement is made by a holder and is not a special indorsement, it is a blank indorsement. For example, the holder of an instrument, intending to make a special indorsement, writes the words "Pay to the order of" without completing the indorsement by writing the name of the indorsee. The holder's signature appears under the quoted words. The indorsement is not a special indorsement because it does not identify a person to whom it makes the instrument payable. Since it is not a special indorsement it is a blank indorsement and the instrument is payable to bearer. The result is analogous to that of a check in which the name of the payee is left blank by the drawer. In that case the check is payable to bearer. See the last paragraphs of Comment 2 to Section 3-115.

A blank indorsement is usually the signature of the indorser on the back of the instrument without other words. Subsection (c) is based on subsection (3) of former Section 3-204. A "restrictive indorsement" described in Section 3-206 can be either a blank indorsement or a special indorsement. "Pay to T, in trust for B" is a restrictive indorsement. It is also a special indorsement because it identifies T as the person to whom the instrument is payable. "For deposit only" followed by the signature of the payee of a check is a restrictive indorsement. It is also a blank indorsement because it does not identify the person to whom the instrument is payable.

3. The only effect of an “anomalous indorsement,” defined in subsection (d), is to make the signer liable on the instrument as an indorser. Such an indorsement is normally made by an accommodation party. Section 3-419.

4. Articles 14 and 16 of the Convention on International Bills of Exchange and International Promissory Notes include similar rules for blank and special indorsements.

§ 28-3-206. Restrictive indorsement. — (1) An indorsement limiting payment to a particular person or otherwise prohibiting further transfer or negotiation of the instrument is not effective to prevent further transfer or negotiation of the instrument.

(2) An indorsement stating a condition to the right of the indorsee to receive payment does not affect the right of the indorsee to enforce the instrument. A person paying the instrument or taking it for value or collection may disregard the condition, and the rights and liabilities of that person are not affected by whether the condition has been fulfilled.

(3) If an instrument bears an indorsement (i) described in section 28-4-201(2)[, Idaho Code], or (ii) in blank or to a particular bank using the words "for deposit," "for collection," or other words indicating a purpose of having the instrument collected by a bank for the indorser or for a particular account, the following rules apply:

(a) A person, other than a bank, who purchases the instrument when so indorsed converts the instrument unless the amount paid for the instrument is received by the indorser or applied consistently with the indorsement.

(b) A depositary bank that purchases the instrument or takes it for collection when so indorsed converts the instrument unless the amount paid by the bank with respect to the instrument is received by the indorser or applied consistently with the indorsement.

(c) A payor bank that is also the depositary bank or that takes the instrument for immediate payment over the counter from a person other than a collecting bank converts the instrument unless the proceeds of the instrument are received by the indorser or applied consistently with the indorsement.

(d) Except as otherwise provided in paragraph (c) of this subsection, a payor bank or intermediary bank may disregard the indorsement and is not liable if the proceeds of the instrument are not received by the indorser or applied consistently with the indorsement.

(4) Except for an indorsement covered in subsection (3) of this section, if an instrument bears an indorsement using words to the effect that payment is to be made to the indorsee as agent, trustee or other fiduciary for the benefit of the indorser or another person, the following rules apply:

(a) Unless there is notice of breach of fiduciary duty as provided in section 28-3-307[, Idaho Code], a person who purchases the instrument from the indorsee or takes the instrument from the indorsee for collection or payment may pay the proceeds of payment or the value given for the instrument to the indorsee without regard to whether the indorsee violates a fiduciary duty to the indorser.

(b) A subsequent transferee of the instrument or person who pays the instrument is neither given notice nor otherwise affected by the restriction in the indorsement unless the transferee or payor knows that the fiduciary dealt with the instrument or its proceeds in breach of fiduciary duty.

(5) The presence on an instrument of an indorsement to which this section applies does not prevent a purchaser of the instrument from becoming a holder in due course of the instrument unless the purchaser is a converter under subsection (3) of this section or has notice or knowledge of breach of fiduciary duty as stated in subsection (4) of this section.

(6) In an action to enforce the obligation of a party to pay the instrument, the obligor has a defense if payment would violate an indorsement to which this section applies and the payment is not permitted by this section.

History.

I.C., § 28-3-206, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-206 was repealed. See Prior Laws, § 28-3-101.

Compiler’s Notes.

The bracketed insertions in the introductory paragraph in subsection (3) and in paragraph (4)(a) were added by the compiler to conform to the

statutory citation style.

CASE NOTES

Decisions Under Prior Law

"For Deposit Only."

An indorsement "for deposit only" was restrictive and precluded indorsee from being a holder in due course, even though indorser was also drawer and payee. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

Qualified Indorsement After Maturity.

Promissory note, negotiable in form, that remained in the hands of its original payee long after maturity and was thereafter transferred by qualified indorsement, never had an origin as a negotiable instrument. Moody v. Morris-Roberts Co., 38 Idaho 414, 226 P. 278 (1923).

Waiver.

The drawer of a trade acceptance who was also the payee may waive a restrictive indorsement for deposit only, placed thereon by him, and convert the holder into a bona fide holder in due course. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 200 et seq.

Official Comment

1. This section replaces former Sections 3-205 and 3-206 and clarifies the law of restrictive indorsements.

2. Subsection (a) provides that an indorsement that purports to limit further transfer or negotiation is ineffective to prevent further transfer or

negotiation. If a payee indorses "Pay A only," A may negotiate the instrument to subsequent holders who may ignore the restriction on the indorsement. Subsection (b) provides that an indorsement that states a condition to the right of a holder to receive payment is ineffective to condition payment. Thus if a payee indorses "Pay A if A ships goods complying with our contract," the right of A to enforce the instrument is not affected by the condition. In the case of a note, the obligation of the maker to pay A is not affected by the indorsement. In the case of a check, the drawee can pay A without regard to the condition, and if the check is dishonored the drawer is liable to pay A. If the check was negotiated by the payee to A in return for a promise to perform a contract and the promise was not kept, the payee would have a defense or counterclaim against A if the check were dishonored and A sued the payee as indorser, but the payee would have that defense or counterclaim whether or not the condition to the right of A was expressed in the indorsement. Former Section 3-206 treated a conditional indorsement like indorsements for deposit or collection. In revised Article 3, Section 3-206(b) rejects that approach and makes the conditional indorsement ineffective with respect to parties other than the indorser and indorsee. Since the indorsements referred to in subsections (a) and (b) are not effective as restrictive indorsements, they are no longer described as restrictive indorsements.

3. The great majority of restrictive indorsements are those that fall within subsection (c) which continues previous law. The depositary bank or the payor bank, if it takes the check for immediate payment over the counter, must act consistently with the indorsement, but an intermediary bank or payor bank that takes the check from a collecting bank is not affected by the indorsement. Any other person is also bound by the indorsement. For example, suppose a check is payable to X, who indorses in blank but writes above the signature the words "For deposit only." The check is stolen and is cashed at a grocery store by the thief. The grocery store indorses the check and deposits it in Depositary Bank. The account of the grocery store is credited and the check is forwarded to Payor Bank which pays the check. Under subsection (c), the grocery store and Depositary Bank are converters of the check because X did not receive the amount paid for the check. Payor Bank and any intermediary bank in the collection process are not liable to X. This Article does not displace the law of waiver as it may apply to restrictive indorsements. The circumstances under which a restrictive

indorsement may be waived by the person who made it is not determined by this Article.

4. Subsection (d) replaces subsection (4) of former Section 3-206. Suppose Payee indorses a check "Pay to T in trust for B." T indorses in blank and delivers it to (a) Holder for value; (b) Depositary Bank for collection; or (c) Payor Bank for payment. In each case these takers can safely pay T so long as they have no notice under Section 3-307 of any breach of fiduciary duty that T may be committing. For example, under subsection (b) of Section 3-307 these takers have notice of a breach of trust if the check was taken in any transaction known by the taker to be for T's personal benefit. Subsequent transferees of the check from Holder or Depositary Bank are not affected by the restriction unless they have knowledge that T dealt with the check in breach of trust.

5. Subsection (f) allows a restrictive indorsement to be used as a defense by a person obliged to pay the instrument if that person would be liable for paying in violation of the indorsement.

§ 28-3-207. Reacquisition. — Reacquisition of an instrument occurs if it is transferred to a former holder, by negotiation or otherwise. A former holder who reacquires the instrument may cancel indorsements made after the reacquirer first became a holder of the instrument. If the cancellation causes the instrument to be payable to the reacquirer or to bearer, the reacquirer may negotiate the instrument. An indorser whose indorsement is canceled is discharged, and the discharge is effective against any subsequent holder.

History.

I.C., § 28-3-207, as added by 1993, ch. 288, § 2, p. 1019; am. 2002, ch. 121, § 5, p. 338.

STATUTORY NOTES

Prior Laws.

Former § 28-3-207 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law Waiver of Restrictive Indorsement.

Drawer of trade acceptance, also the payee, might have waived restriction "for deposit only" which he placed thereon, sell the acceptance to the bank of deposit, and convert the bank into a bona fide holder in due course. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

Official Comment Section 3-207 restates former Section 3-208. Reacquisition refers to cases in which a former holder reacquires the instrument either by negotiation from the present holder or by a transfer other than negotiation. If the reacquisition is by negotiation, the former holder reacquires the status of holder. Although Section 3-207 allows the holder to cancel all indorsements made after the holder first acquired holder status, cancellation is not necessary. Status of holder is not affected whether or not cancellation is made. But if the

reacquisition is not the result of negotiation the former holder can obtain holder status only by striking the former holder's indorsement and any subsequent indorsements. The latter case is an exception to the general rule that if an instrument is payable to an identified person, the indorsement of that person is necessary to allow a subsequent transferee to obtain the status of holder. Reacquisition without indorsement by the person to whom the instrument is payable is illustrated by two examples: Case #1. X, a former holder, buys the instrument from Y, the present holder. Y delivers the instrument to X but fails to indorse it. Negotiation does not occur because the transfer of possession did not result in X's becoming holder. Section 3-201(a). The instrument by its terms is payable to Y, not to X. But X can obtain the status of holder by striking X's indorsement and all subsequent indorsements. When these indorsements are struck, the instrument by its terms is payable either to X or to bearer, depending upon how X originally became holder. In either case X becomes holder. Section 1-201(20).

> **Case #2.** X, the holder of an instrument payable to X, negotiates it to Y by special indorsement. The negotiation is part of an underlying transaction between X and Y. The underlying transaction is rescinded by agreement of X and Y, and Y returns the instrument without Y's indorsement. The analysis is the same as that in Case #1. X can obtain holder status by cancelling X's indorsement to Y.

In Case #1 and Case #2, X acquired ownership of the instrument after reacquisition, but X's title was clouded because the instrument by its terms was not payable to X. Normally, X can remedy the problem by obtaining Y's indorsement, but in some cases X may not be able to conveniently obtain that indorsement. Section 3-207 is a rule of convenience which relieves X of the burden of obtaining an indorsement that serves no substantive purpose. The effect of cancellation of any indorsement under Section 3-207 is to nullify it. Thus, the person whose indorsement is canceled is relieved of indorser's liability. Since cancellation is notice of discharge, discharge is effective even with respect to the rights of a holder in due course. Sections 3-601 and 3-604.

§ 28-3-208. Reacquisition. [Repealed.]

STATUTORY NOTES

Prior Laws.

Former § 28-3-208 was repealed. See Prior Laws, § 28-3-101.

Part 3
Enforcement of Instruments

§ 28-3-301. Person entitled to enforce instrument. — "Person entitled to enforce" an instrument means (i) the holder of the instrument, (ii) a nonholder in possession of the instrument who has the rights of a holder, or (iii) a person not in possession of the instrument who is entitled to enforce the instrument pursuant to section 28-3-309[, Idaho Code] or 28-3-418(4)[, Idaho Code]. A person may be a person entitled to enforce the instrument even though the person is not the owner of the instrument or is in wrongful possession of the instrument.

History.

I.C., § 28-3-301, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-301 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in the first sentence were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Fiduciaries.

Holder of note, who brought a draft for which note was executed, with money held by him only for investment for another, was entitled to prosecute an action on the note in his own name. Ritter v. Moore, 64 Idaho 144, 128 P.2d 639 (1942).

Holder for Collection.

Holder of a negotiable instrument for collection might have sued thereon in his own name. Craig v. Palo Alto Stock Farm, 16 Idaho 701, 102 P. 393 (1909); Anderson v. Coolin, 28 Idaho 494, 155 P. 677 (1916); Utah Implement-Vehicle Co. v. Kenyon, 30 Idaho 407, 164 P. 1176 (1917).

The holder of a note indorsed to another for collection might have recovered thereon in his own name. McCornick & Co. v. Tolmie Bros., 42 Idaho 1, 243 P. 355 (1926).

Presumption of Ownership.

In absence of a specific agreement or understanding that a negotiable instrument should be a pledge, holder thereof was presumed to be owner and was entitled to maintain his action thereon. Home Land Co. v. Osborn, 19 Idaho 95, 112 P. 764 (1910).

The possession of an instrument payable to order and properly indorsed was prima facie evidence of ownership. Home Land Co. v. Osborn, 19 Idaho 95, 112 P. 764 (1910); McCornick & Co. v. Tolmie Bros., 42 Idaho 1, 243 P. 355 (1926); Ritter v. Moore, 64 Idaho 144, 128 P.2d 639 (1942).

The presumption of ownership of a negotiable instrument arising from possession thereof was rebuttable. Portland Cattle Loan Co. v. Gemmell, 41 Idaho 756, 242 P. 798 (1925).

Anyone in possession of a negotiable instrument may maintain an action thereon and possession of a note and pleading thereof was sufficient evidence of ownership to put defendant on his proof. C.I.T. Corp. v. Elliott, 66 Idaho 384, 159 P.2d 891 (1945).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 209 et seq.

Official Comment

This section replaces former Section 3-301 that stated the rights of a holder. The rights stated in former Section 3-301 to transfer, negotiate, enforce, or discharge an instrument are stated in other sections of Article 3. In revised Article 3, Section 3-301 defines "person entitled to enforce" an instrument. The definition recognizes that enforcement is not limited to holders. The quoted phrase includes a person enforcing a lost or stolen instrument. Section 3-309. It also includes a person in possession of an instrument who is not a holder. A nonholder in possession of an instrument includes a person that acquired rights of a holder by subrogation or under Section 3-203(a). It also includes both a remitter that has received an instrument from the issuer but has not yet transferred or negotiated the instrument to another person and also any other person who under applicable law is a successor to the holder or otherwise acquires the holder's rights.

§ 28-3-302. Holder in due course. — (1) Subject to subsection (3) of this section and section 28-3-106(4)[, Idaho Code], "holder in due course" means the holder of an instrument if:

(a) The instrument when issued or negotiated to the holder does not bear such apparent evidence of forgery or alteration or is not otherwise so irregular or incomplete as to call into question its authenticity; and

(b) The holder took the instrument (i) for value, (ii) in good faith, (iii) without notice that the instrument is overdue or has been dishonored or that there is an uncured default with respect to payment of another instrument issued as part of the same series, (iv) without notice that the instrument contains an unauthorized signature or has been altered, (v) without notice of any claim to the instrument described in section 28-3-306[, Idaho Code], and (vi) without notice that any party has a defense or claim in recoupment described in section 28-3-305(1)[, Idaho Code].

(2) Notice of discharge of a party, other than discharge in an insolvency proceeding, is not notice of a defense under subsection (1) of this section, but discharge is effective against a person who became a holder in due course with notice of the discharge. Public filing or recording of a document does not of itself constitute notice of a defense, claim in recoupment, or claim to the instrument.

(3) Except to the extent a transferor or predecessor in interest has rights as a holder in due course, a person does not acquire rights of a holder in due course of an instrument taken (i) by legal process or by purchase in an execution, bankruptcy, or creditor's sale or similar proceeding, (ii) by purchase as part of a bulk transaction not in ordinary course of business of the transferor, or (iii) as the successor in interest to an estate or other organization.

(4) If, under section 28-3-303(1)(a)[, Idaho Code], the promise of performance that is the consideration for an instrument has been partially performed, the holder may assert rights as a holder in due course of the instrument only to the fraction of the amount payable under the instrument

equal to the value of the partial performance divided by the value of the promised performance.

(5) If (i) the person entitled to enforce an instrument has only a security interest in the instrument, and (ii) the person obliged to pay the instrument has a defense, claim in recoupment, or claim to the instrument that may be asserted against the person who granted the security interest, the person entitled to enforce the instrument may assert rights as a holder in due course only to an amount payable under the instrument which, at the time of enforcement of the instrument, does not exceed the amount of the unpaid obligation secured.

(6) To be effective, notice must be received at a time and in a manner that gives a reasonable opportunity to act on it.

(7) This section is subject to any law limiting status as a holder in due course in particular classes of transactions.

History.

I.C., § 28-3-302, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-302 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in the introductory paragraph in subsection (1), in paragraph (1)(b), and in subsection (4) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Blue sky law.

Burden of proof.

Defenses.

Fraud in inception.

Good faith.

Holder in due course.

Nonpayment of installment.

Nonpayment of interest installment.

Stop payment.

Blue Sky Law.

Note given in payment for stock of a company which had not complied with Blue Sky Law was voidable in the hands of one not a bona fide holder, but good in the hands of a bona fide holder. Ashley & Rumelin v. Brady, 41 Idaho 160, 238 P. 314 (1925); Evans v. Wood, 41 Idaho 679, 241 P. 609 (1925); McCornick & Co. v. Tolmie Bros., 46 Idaho 544, 269 P. 96 (1928); Ashley State Bank v. Hood, 47 Idaho 780, 279 P. 418 (1929).

Burden of Proof.

Burden was upon holder in due course to show that he took instrument without any knowledge of defect of title. Wright v. Spencer, 39 Idaho 60, 226 P. 173 (1924); First Nat'l Bank v. Campbell, 39 Idaho 736, 230 P. 43 (1924).

Defenses.

Where the affidavit of the bank stated that all prior notes had been cancelled and that the borrower was not indebted to the bank on any prior notes, such was an effective renunciation of the rights of the bank and an effective defense in the borrower to any later action on the prior notes. F & M State Bank v. Lloyd, 99 Idaho 416, 582 P.2d 1094 (1978).

Fraud in Inception.

Fraud in inception of a negotiable note would not defeat third person's right of recovery if he took note in due course, for value and without notice. First Nat'l Bank v. Pond, 39 Idaho 770, 230 P. 344 (1924).

Good Faith.

Bank was a holder in due course though material furnished by payee was allegedly defective and completion certificate was signed only by the wife,

where the bank took the note, which was regular on its face, without any notice of alleged defects. United States v. Skinner, 137 F. Supp. 234 (D. Idaho 1956).

Purchaser of negotiable instrument before maturity in good faith and for valuable consideration and without notice of defects was "holder in due course" within meaning of former statute. Wright v. Gerber, 46 Idaho 476, 269 P. 85 (1928).

Purchaser of negotiable paper in due course and before maturity was not under any duty to make inquiry as to title to paper, fair and regular on its face, or to inquire into consideration therefor or transaction out of which it arose. Wright v. Gerber, 46 Idaho 476, 269 P. 85 (1928).

Rights of holder of negotiable instrument were to be determined by simple test of honesty and good faith, and not by speculative issues as to diligence or negligence. Wright v. Gerber, 46 Idaho 476, 269 P. 85 (1928).

Transferee of note, fair and regular on its face, was not bound to inquire whether payee complied with state laws, unless he knew facts putting him on inquiry. Chesney v. Bodily, 50 Idaho 597, 298 P. 937 (1931).

The holder of a note was a holder in due course where he bought a draft, for which the note was executed, with money belonging to his mother who had entrusted funds to the holder for investment purposes. Ritter v. Moore, 64 Idaho 144, 128 P.2d 639 (1942).

Check to payee and a credit statement application were collateral proof affording a presumption that a note on which the action was based was purchased by plaintiff for a valuable consideration, and that the defendant by signing the credit application had knowledge of such fact and acquiesced. C.I.T. Corp. v. Elliott, 66 Idaho 384, 159 P.2d 891 (1945).

Whether payee was acting in good faith or had notice of a defense against or a claim to a cashier's check made out to payee and used to purchase merchandise from same was a question of fact, and there was substantial and competent evidence to support the findings that led to the magistrate's conclusion that payee was a holder in due course. Valley Bank v. Monarch Inv. Co., 118 Idaho 747, 800 P.2d 634 (1990).

Holder in Due Course.

Facts held to show holder not to be in due course. Winter v. Nobs, 19 Idaho 18, 112 P. 525 (1910); Park v. Johnson, 20 Idaho 548, 119 P. 52 (1911); Brown v. Miller, 22 Idaho 307, 125 P. 981 (1912); Altschul v. Rogers, 22 Idaho 512, 126 P. 1048 (1912).

Facts held to show holder in due course. Nelson v. Hudgel, 23 Idaho 327, 130 P. 85 (1913); Southwest Nat'l Bank v. Baker, 23 Idaho 428, 130 P. 799 (1913); Burdell v. Nereson, 28 Idaho 129, 152 P. 576 (1915); Southwest Nat'l Bank v. Lindsley, 29 Idaho 343, 159 P. 1082 (1916).

Payee of a negotiable instrument might have become a holder thereof in due course. Redfield v. Wells, 31 Idaho 415, 173 P. 640 (1918).

Where plaintiff took promissory notes which were five years overdue on their face, it could not be a holder in due course and was subject to the defenses under former section, including the defense of delivery for a special purpose; thus, where defendants carried their burden under another former section of showing that the notes had been given and received for the special purpose of interim security and were to serve only as additional security until substitute security could be provided in the form of a mortgage from the plaintiff, the trial court did not err in holding that, upon plaintiff giving substitute security in the form of a mortgage, any obligation on the notes was extinguished and that the transfer of the notes did not transfer an enforceable obligation. Ventures, Inc. v. Jones, 101 Idaho 837, 623 P.2d 145 (1981).

Nonpayment of Installment.

If installment of note was overdue at time it was transferred, purchaser took whole note as overdue paper and was not holder in due course. GMAC v. Talbott, 39 Idaho 707, 230 P. 30 (1924).

Nonpayment of Interest Installment.

Mere failure to pay periodical installment of interest would not amount to a dishonor of negotiable instrument and would not render the instrument overdue. However, knowledge by purchaser of overdue installment of interest was a circumstance to be considered to determining his good faith in purchasing note. Winter v. Nobs, 19 Idaho 18, 112 P. 525 (1910).

Stop Payment.

Where unauthorized agent of company took purchaser's check, brought it to bank upon which it was drawn, and replaced it with a cashier's check to company, and where purchaser subsequently placed a stop payment order on the original check, the stop payment order had no effect upon the obligation of the bank to pay cashier's check. Valley Bank v. Monarch Inv. Co., 118 Idaho 747, 800 P.2d 634 (1990).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 57 et seq.

C.J.S. — 10 C.J.S., Bills and Notes, § 207 et seq.

ALR. — Payee as holder in due course. 2 A.L.R.3d 1151.

What constitutes taking instrument in good faith, and without notice of infirmities or defenses to support status under UCC § 3-302. 36 A.L.R.4th 212.

Official Comment

1. Subsection (a)(1) is a return to the N.I.L. rule that the taker of an irregular or incomplete instrument is not a person the law should protect against defenses of the obligor or claims of prior owners. This reflects a policy choice against extending the holder in due course doctrine to an instrument that is so incomplete or irregular "as to call into question its authenticity." The term "authenticity" is used to make it clear that the irregularity or incompleteness must indicate that the instrument may not be what it purports to be. Persons who purchase or pay such instruments should do so at their own risk. Under subsection (1) of former Section 3-304, irregularity or incompleteness gave a purchaser notice of a claim or defense. But it was not clear from that provision whether the claim or defense had to be related to the irregularity or incomplete aspect of the instrument. This ambiguity is not present in subsection (a)(1).

2. Subsection (a)(2) restates subsection (1) of former Section 3-302. Section 3-305(a) makes a distinction between defenses to the obligation to pay an instrument and claims in recoupment by the maker or drawer that may be asserted to reduce the amount payable on the instrument. Because of this distinction, which was not made in former Article 3, the reference in

subsection (a)(2)(vi) is to both a defense and a claim in recoupment. Notice of forgery or alteration is stated separately because forgery and alteration are not technically defenses under subsection (a) of Section 3-305.

3. Discharge is also separately treated in the first sentence of subsection (b). Except for discharge in an insolvency proceeding, which is specifically stated to be a real defense in Section 3-305(a)(1), discharge is not expressed in Article 3 as a defense and is not included in Section 3-305(a)(2). Discharge is effective against anybody except a person having rights of a holder in due course who took the instrument without notice of the discharge. Notice of discharge does not disqualify a person from becoming a holder in due course. For example, a check certified after it is negotiated by the payee may subsequently be negotiated to a holder. If the holder had notice that the certification occurred after negotiation by the payee, the holder necessarily had notice of the discharge of the payee as indorser. Section 3-415(d). Notice of that discharge does not prevent the holder from becoming a holder in due course, but the discharge is effective against the holder. Section 3-601(b). Notice of a defense under Section 3-305(a)(1) of a maker, drawer or acceptor based on a bankruptcy discharge is different. There is no reason to give holder in due course status to a person with notice of that defense. The second sentence of subsection (b) is from former Section 3-304(5).

4. Professor Britton in his treatise Bills and Notes 309 (1961) stated: "A substantial number of decisions before the [N.I.L.] indicates that at common law there was nothing in the position of the payee as such which made it impossible for him to be a holder in due course." The courts were divided, however, about whether the payee of an instrument could be a holder in due course under the N.I.L.. Some courts read N.I.L. § 52(4) to mean that a person could be a holder in due course only if the instrument was "negotiated" to that person. N.I.L. § 30 stated that "an instrument is negotiated when it is transferred from one person to another in such manner as to constitute the transferee the holder thereof." Normally, an instrument is "issued" to the payee; it is not transferred to the payee. N.I.L. § 191 defined "issue" as the "first delivery of the instrument *** to a person who takes it as a holder." Thus, some courts concluded that the payee never could be a holder in due course. Other courts concluded that there was no evidence that the N.I.L. was intended to change the common law rule that

the payee could be a holder in due course. Professor Britton states on p. 318: “The typical situations which raise the [issue] are those where the defense of a maker is interposed because of fraud by a [maker who is] principal debtor *** against a surety co-maker, or where the defense of fraud by a purchasing remitter is interposed by the drawer of the instrument against the good faith purchasing payee.”

Former Section 3-302(2) stated: “A payee may be a holder in due course.” This provision was intended to resolve the split of authority under the N.I.L.. It made clear that there was no intent to change the common-law rule that allowed a payee to become a holder in due course. See Comment 2 to former Section 3-302. But there was no need to put subsection (2) in former Section 3-302 because the split in authority under the N.I.L. was caused by the particular wording of N.I.L. § 52(4). The troublesome language in that section was not repeated in former Article 3 nor is it repeated in revised Article 3. Former Section 3-302(2) has been omitted in revised Article 3 because it is surplusage and may be misleading. The payee of an instrument can be a holder in due course, but use of the holder-in-due-course doctrine by the payee of an instrument is not the normal situation.

The primary importance of the concept of holder in due course is with respect to assertion of defenses or claims in recoupment (Section 3-305) and of claims to the instrument (Section 3-306). The holder-in-due-course doctrine assumes the following case as typical. Obligor issues a note or check to Obligee. Obligor is the maker of the note or drawer of the check. Obligee is the payee. Obligor has some defense to Obligor’s obligation to pay the instrument. For example, Obligor issued the instrument for goods that Obligee promised to deliver. Obligee never delivered the goods. The failure of Obligee to deliver the goods is a defense. Section 3-303(b). Although Obligor has a defense against Obligee, if the instrument is negotiated to Holder and the requirements of subsection (a) are met, Holder may enforce the instrument against Obligor free of the defense. Section 3-305(b). In the typical case the holder in due course is not the payee of the instrument. Rather, the holder in due course an immediate or remote transferee of the payee. If Obligor in our example is the only obligor on the check or note, the holder-in-due-course doctrine is irrelevant in determining rights between Obligor and Obligee with respect to the instrument.

But in a small percentage of cases it is appropriate to allow the payee of an instrument to assert rights as a holder in due course. The cases are like those referred to in the quotation from Professor Britton referred to above, or other cases in which conduct of some third party is the basis of the defense of the issuer of the instrument. The following are examples:

Case #1. Buyer pays for goods bought from Seller by giving to Seller a cashier's check bought from Bank. Bank has a defense to its obligation to pay the check because Buyer bought the check from Bank with a check known to be drawn on an account with insufficient funds to cover the check. If Bank issued the check to Buyer as payee and Buyer indorsed it over to Seller, it is clear that Seller can be a holder in due course taking free of the defense if Seller had no notice of the defense. Seller is a transferee of the check. There is no good reason why Seller's position should be any different if Bank drew the check to the order of Seller as payee. In that case, when Buyer took delivery of the check from Bank, Buyer became the owner of the check even though Buyer was not the holder. Buyer was a remitter. Section 3-103(a)(11). At that point nobody was the holder. When Buyer delivered the check to Seller, ownership of the check was transferred to Seller who also became the holder. This is a negotiation. Section 3-201. The rights of Seller should not be affected by the fact that in one case the negotiation to Seller was by a holder and in the other case the negotiation was by a remitter. Moreover, it should be irrelevant whether Bank delivered the check to Buyer and Buyer delivered it to Seller or whether Bank delivered it directly to Seller. In either case Seller can be a holder in due course that takes free of Bank's defense.

Case #2. X fraudulently induces Y to join X in a spurious venture to purchase a business. The purchase is to be financed by a bank loan for part of the price. Bank lends money to X and Y by deposit in a joint account of X and Y who sign a note payable to Bank for the amount of the loan. X then withdraws the money from the joint account and absconds. Bank acted in good faith and without notice of the fraud of X against Y. Bank is payee of the note executed by Y, but its right to enforce the note against Y should not be affected by the fact that Y was induced to execute the note by the fraud of X. Bank can be a holder in due course that takes free of the defense of Y. Case #2 is similar to Case

#1. In each case the payee of the instrument has given value to the person committing the fraud in exchange for the obligation of the person against whom the fraud was committed. In each case the payee was not party to the fraud and had no notice of it.

Suppose in Case #2 that the note does not meet the requirements of Section 3-104(a) and thus is not a negotiable instrument covered by Article 3. In that case, Bank cannot be a holder in due course but the result should be the same. Bank's rights are determined by general principles of contract law. Restatement Second, Contracts § 164(2) governs the case. If Y is induced to enter into a contract with Bank by a fraudulent misrepresentation by X, the contract is voidable by Y unless Bank "in good faith and without reason to know of the misrepresentation either gives value or relies materially on the transaction." Comment e to § 164(2) states:

> "This is the same principle that protects an innocent person who purchases goods or commercial paper in good faith, without notice and for value from one who obtained them from the original owner by a misrepresentation. See Uniform Commercial Code §§ 2-403(1), 3-305. In the cases that fall within [§ 164(2)], however, the innocent person deals directly with the recipient of the misrepresentation, which is made by one not a party to the contract."

The same result follows in Case #2 if Y had been induced to sign the note as an accommodation party (Section 3-419). If Y signs as co-maker of a note for the benefit of X, Y is a surety with respect to the obligation of X to pay the note but is liable as maker of the note to pay Bank. Section 3-419(b). If Bank is a holder in due course, the fraud of X cannot be asserted against Bank under Section 3-305(b). But the result is the same without resort to holder-in-due-course doctrine. If the note is not a negotiable instrument governed by Article 3, general rules of suretyship apply. Restatement, Security § 119 states that the surety (Y) cannot assert a defense against the creditor (Bank) based on the fraud of the principal (X) if the creditor "without knowledge of the fraud *** extended credit to the principal on the security of the surety's promise ***." The underlying principle of § 119 is the same as that of § 164(2) of Restatement Second, Contracts.

Case #3. Corporation draws a check payable to Bank. The check is given to an officer of Corporation who is instructed to deliver it to Bank in payment of a debt owed by Corporation to Bank. Instead, the officer, intending to defraud Corporation, delivers the check to Bank in payment of the officer's personal debt, or the check is delivered to Bank for deposit to the officer's personal account. If Bank obtains payment of the check, Bank has received funds of Corporation which have been used for the personal benefit of the officer. Corporation in this case will assert a claim to the proceeds of the check against Bank. If Bank was a holder in due course of the check it took the check free of Corporation's claim. Section 3-306. The issue in this case is whether Bank had notice of the claim when it took the check. If Bank knew that the officer was a fiduciary with respect to the check, the issue is governed by Section 3-307.

Case #4. Employer, who owed money to X, signed a blank check and delivered it to Secretary with instructions to complete the check by typing in X's name and the amount owed to X. Secretary fraudulently completed the check by typing in the name of Y, a creditor to whom Secretary owed money. Secretary then delivered the check to Y in payment of Secretary's debt. Y obtained payment of the check. This case is similar to Case #3. Since Secretary was authorized to complete the check, Employer is bound by Secretary's act in making the check payable to Y. The drawee bank properly paid the check. Y received funds of Employer which were used for the personal benefit of Secretary. Employer asserts a claim to these funds against Y. If Y is a holder in due course, Y takes free of the claim. Whether Y is a holder in due course depends upon whether Y had notice of Employer's claim.

5. Subsection (c) is based on former Section 3-302(3). Like former Section 3-302(3), subsection (c) is intended to state existing case law. It covers a few situations in which the purchaser takes an instrument under unusual circumstances. The purchaser is treated as a successor in interest to the prior holder and can acquire no better rights. But if the prior holder was a holder in due course, the purchaser obtains rights of a holder in due course.

Subsection (c) applies to a purchaser in an execution sale or sale in bankruptcy. It applies equally to an attaching creditor or any other person

who acquires the instrument by legal process or to a representative, such as an executor, administrator, receiver or assignee for the benefit of creditors, who takes the instrument as part of an estate. Subsection (c) applies to bulk purchases lying outside of the ordinary course of business of the seller. For example, it applies to the purchase by one bank of a substantial part of the paper held by another bank which is threatened with insolvency and seeking to liquidate its assets. Subsection (c) would also apply when a new partnership takes over for value all of the assets of an old one after a new member has entered the firm, or to a reorganized or consolidated corporation taking over the assets of a predecessor.

In the absence of controlling state law to the contrary, subsection (c) applies to a sale by a state bank commissioner of the assets of an insolvent bank. However, subsection (c) applies to a sale by a state bank commissioner of the assets of an insolvent bank. Under the governing federal law, the FDIC and similar financial institution insurers are given holder in due course status and that status is also acquired by their assignees under the shelter doctrine.

6. Subsections (d) and (e) clarify two matters not specifically addressed by former Article 3:

Case #5. Payee negotiates a $1,000 note to Holder who agrees to pay $900 for it. After paying $500, Holder learns that Payee defrauded Maker in the transaction giving rise to the note. Under subsection (d) Holder may assert rights as a holder in due course to the extent of $555.55 ($500 °s $900 = .555 X $1,000 = $555.55). This formula rewards Holder with a ratable portion of the bargained for profit.

Case #6. Payee negotiates a note of Maker for $1,000 to Holder as security for payment of Payee's debt to Holder of $600. Maker has a defense which is good against Payee but of which Holder has no notice. Subsection (e) applies. Holder may assert rights as a holder in due course only to the extent of $600. Payee does not get the benefit of the holder-in-due-course status of Holder. With respect to $400 of the note, Maker may assert any rights that Maker has against Payee. A different result follows if the payee of a note negotiated it to a person who took it as a holder in due course and that person pledged the note as security for a debt. Because the defense cannot be asserted against the pledgor, the pledgee

can assert rights as a holder in due course for the full amount of the note for the benefit of both the pledgor and the pledgee.

7. There is a large body of state statutory and case law restricting the use of the holder in due course doctrine in consumer transactions as well as some business transactions that raise similar issues. Subsection (g) subordinates Article 3 to that law and any other similar law that may evolve in the future. Section 3-106(d) also relates to statutory or administrative law intended to restrict use of the holder-in-due-course doctrine. See Comment 3 to Section 3-106.

8. The status of holder in due course resembles the status of protected holder under Article 29 of the Convention on International Bills of Exchange and International Promissory Notes. The requirements for being a protected holder under Article 29 generally track those of Section 3-302.

§ 28-3-303. Value and consideration. — (1) An instrument is issued or transferred for value if:

(a) The instrument is issued or transferred for a promise of performance, to the extent the promise has been performed;

(b) The transferee acquires a security interest or other lien in the instrument other than a lien obtained by judicial proceeding;

(c) The instrument is issued or transferred as payment of, or as security for, an antecedent claim against any person, whether or not the claim is due;

(d) The instrument is issued or transferred in exchange for a negotiable instrument; or

(e) The instrument is issued or transferred in exchange for the incurring of an irrevocable obligation to a third party by the person taking the instrument.

(2) "Consideration" means any consideration sufficient to support a simple contract. The drawer or maker of an instrument has a defense if the instrument is issued without consideration. If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed. If an instrument is issued for value as stated in subsection (1) of this section, the instrument is also issued for consideration.

History.

I.C., § 28-3-303, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-303 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

Affirmative Defense.

Under certain conditions parol evidence may have been introduced to show the true consideration or want of consideration for a promissory note or other instrument. However, the defense of want and failure of consideration are affirmative defenses to be pleaded. Rosenberry v. Clark, 85 Idaho 317, 379 P.2d 638 (1963).

Failure of Consideration.

Partial failure of consideration was no defense unless there was a rescission and return of the consideration received. Pioneer Bank & Trust Co. v. MacNab, 41 Idaho 146, 238 P. 295 (1925).

Where consideration for giving of note was promise to construct drainage system under supervision of an engineer, the consideration failed when an ineffectual system was constructed without engineer's advice. Sheppard Inv. Co. v. Roscoe, 48 Idaho 405, 283 P. 519 (1929).

Fraud.

Fraud was a valid defense between the parties. Brown v. Miller, 22 Idaho 307, 125 P. 981 (1912).

In pleading fraud as a defense, injury to the maker of the note resulting from the fraud must have been averred. Frank v. Davis, 34 Idaho 678, 203 P. 287 (1921).

Where plaintiff sued on a note proved by the defendant to have been procured by fraud, plaintiff must affirmatively show he was a holder in due course. Wright v. Spencer, 39 Idaho 60, 226 P. 173 (1924).

In an action on a promissory note, given in payment for a correspondence course, the evidence of the defendant that the note was procured by fraudulent representations as to the course was sufficient to sustain a directed verdict. Idaho State Merchants' Protective Ass'n v. Roche, 53 Idaho 115, 22 P.2d 136 (1933).

Gambling Debt.

A check given, with knowledge of the plaintiff, for the purpose of procuring money with which to gamble, could not be recovered on by plaintiff, but it was otherwise if the check was regular on its face and the plaintiff was a holder without notice. Camas Prairie State Bank v. Newman, 15 Idaho 719, 99 P. 833 (1909).

Inadequacy Consideration.

Inadequacy of consideration was no defense to an action on a promissory note, unless there was fraud also on part of the promisee. Harshbarger v. Eby, 28 Idaho 753, 156 P. 619 (1916).

Lack of Consideration.

The maker of a note could not defend on ground of lack of consideration where his answer admitted receiving and retaining a part of the consideration. Daniels v. Englehart, 18 Idaho 548, 111 P. 3 (1910).

Where lack of consideration was urged as defense, question of amount of wheat delivered to plaintiff, value thereof, price credited to defendant, and nature of the agreement are for the jury where evidence is conflicting. Colorado Milling & Elevator Co. v. Proctor, 58 Idaho 578, 76 P.2d 438 (1938).

Pleading and Proof.

The burden of proving valuable consideration was on plaintiff where defendant pleaded want of consideration as a defense and introduces evidence to that effect. Casey v. Empey, 34 Idaho 244, 200 P. 122 (1921).

Lack of consideration was affirmative defense which must have been pleaded. Bow v. R. & N. Oil Gas Co., 43 Idaho 80, 251 P. 295 (1926).

Answer setting up mere naked denial of averments of complaint was not sufficient to raise either issue of want of consideration or payment. Bow v. R. & N. Oil Gas Co., 43 Idaho 80, 251 P. 295 (1926).

That accommodation maker received no consideration for note was no defense to its payment. Central Bank v. Perkins, 43 Idaho 310, 251 P. 627 (1926).

Where defendant pleaded failure of consideration, he must have established such defense by a fair preponderance of evidence. First Nat'l Bank v. Doschades, 47 Idaho 661, 279 P. 416 (1929).

Where defendant pleaded want of consideration and affirmative defense of illegal consideration, such defenses were inconsistent and one of them should have been stricken or defendant should have been compelled to elect on which he would stand. Harbour v. Turner, 48 Idaho 364, 282 P. 79 (1929).

Burden of showing want of consideration to support a negotiable instrument laid with party who sought to avoid such instrument. McCarthy v. Harrop, 51 Idaho 107, 3 P.2d 458 (1931).

Presumption as to Consideration.

A note executed and delivered to bank containing the words "We promise to pay" was deemed prima facie to have been issued for valuable consideration. Tritthart v. Tritthart, 24 Idaho 186, 133 P. 121 (1913).

Since consideration was presumed, evidence to establish consideration was not required. Casey v. Empey, 34 Idaho 244, 200 P. 122 (1921).

Promissory note imported consideration and it was not necessary that consideration be alleged in complaint. Bow v. R. & N. Oil Gas Co., 43 Idaho 80, 251 P. 295 (1926).

Where contract of indorsement, made after delivery by person other than payee or holder, was in writing, there was a presumption of consideration. Thomas v. Hoebel, 46 Idaho 744, 271 P. 931 (1928).

Promissory note imports a consideration, and the burden of proving want of it laid on the party attacking. Colorado Milling & Elevator Co. v. Proctor, 58 Idaho 578, 76 P.2d 438 (1938).

Sufficiency of Consideration.

Past performance under an unenforceable contract was good consideration. Coe v. McGran, 23 Idaho 582, 131 P. 1110 (1913).

Services performed in taking care of the drawer of a check, which probably would not have been performed except for promises of compensation, were sufficient consideration. Coe v. McGran, 23 Idaho 582, 131 P. 1110 (1913).

An existing debt might have been represented by maker's own note and surrender of such note would have been good consideration for a new obligation. Miller v. Del Rio Mining & Milling Co., 25 Idaho 83, 136 P. 448 (1913); Fidelity State Bank v. Miller, 29 Idaho 777, 162 P. 244 (1916).

A previous deposit in a bank to account of a note maker, but not accepted by him, was good consideration for an assignment of the note by the bank to the depositor. Jones v. Bussell, 44 Idaho 27, 255 P. 303 (1927).

Extension of time within which to pay indebtedness represented by note and mortgage was sufficient consideration for note and mortgage evidencing down payment, as was also prevention of vendor, during life of agreement, from making sale of land to anyone else. Hinsch v. Mothorn, 44 Idaho 539, 258 P. 540 (1927).

Any consideration that would support a simple contract was sufficient to support indorsement made after delivery. Thomas v. Hoebel, 46 Idaho 744, 271 P. 931 (1928).

Any consideration which would be sufficient to uphold an ordinary contract would be sufficient consideration to validate a promissory note. Hallowell v. Turner, 94 Idaho 718, 496 P.2d 955 (1972).

Third Parties.

It was not necessary that consideration for indorsement should pass from promisee, but might have come from third person not a party to instrument. Thomas v. Hoebel, 46 Idaho 744, 271 P. 931 (1928).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 121 et seq.

15A Am. Jur. 2d, Commercial Code, § 8.

ALR. — When is instrument issued or transferred for "value" under UCC § 3-303. 77 A.L.R.5th 429.

Official Comment

1. Subsection (a) is a restatement of former Section 3-303 and subsection (b) replaces former Section 3-408. The distinction between value and consideration in Article 3 is a very fine one. Whether an instrument is taken for value is relevant to the issue of whether a holder is a holder in due course. If an instrument is not issued for consideration the issuer has a defense to the obligation to pay the instrument. Consideration is defined in subsection (b) as "any consideration sufficient to support a simple contract." The definition of value in Section 1-201(44) [now 1-204], which doesn't apply to Article 3, includes "any consideration sufficient to support a simple contract." Thus, outside Article 3, anything that is consideration is also value. A different rule applies in Article 3. Subsection (b) of Section 3-303 states that if an instrument is issued for value it is also issued for consideration.

Case #1. X owes Y $1,000. The debt is not represented by a note. Later X issues a note to Y for the debt. Under subsection (a)(3) X's note is issued for value. Under subsection (b) the note is also issued for consideration whether or not, under contract law, Y is deemed to have given consideration for the note.

Case #2. X issues a check to Y in consideration of Y's promise to perform services in the future. Although the executory promise is consideration for issuance of the check it is value only to the extent the promise is performed. Subsection (a)(1).

Case #3. X issues a note to Y in consideration of Y's promise to perform services. If at the due date of the note Y's performance is not yet due, Y may enforce the note because it was issued for consideration. But, if at the due date of the note, Y's performance is due and has not been performed, X has a defense. Subsection (b).

2. Subsection (a), which defines value, has primary importance in cases in which the issue is whether the holder of an instrument is a holder in due course and particularly to cases in which the issuer of the instrument has a defense to the instrument. Suppose Buyer and Seller signed a contract on April 1 for the sale of goods to be delivered on May 1. Payment of 50% of the price of the goods was due upon signing of the contract. On April 1 Buyer delivered to Seller a check in the amount due under the contract. The check was drawn by X to Buyer as payee and was indorsed to Seller. When the check was presented for payment to the drawee on April 2, it was dishonored because X had stopped payment. At that time Seller had not taken any action to perform the contract with Buyer. If X has a defense on the check, the defense can be asserted against Seller who is not a holder in due course because Seller did not give value for the check. Subsection (a)(1). The policy basis for subsection (a)(1) is that the holder who gives an executory promise of performance will not suffer an out-of-pocket loss to the extent the executory promise is unperformed at the time the holder learns of dishonor of the instrument. When Seller took delivery of the check on April 1, Buyer's obligation to pay 50% of the price on that date was suspended, but when the check was dishonored on April 2 the obligation revived. Section 3-310(b). If payment for goods is due at or before delivery and the buyer fails to make the payment, the seller is excused from performing the promise to deliver the goods. Section 2-703. Thus, Seller is protected from an out-of-pocket loss even if the check is not enforceable. Holder-in-due-course status is not necessary to protect Seller.

3. Subsection (a)(2) equates value with the obtaining of a security interest or a nonjudicial lien in the instrument. The term "security interest" covers Article 9 cases in which an instrument is taken as collateral as well as bank collection cases in which a bank acquires a security interest under Section 4-210. The acquisition of a common-law or statutory banker's lien is also value under subsection (a)(2). An attaching creditor or other person who

acquires a lien by judicial proceedings does not give value for the purposes of subsection (a)(2).

4. Subsection (a)(3) follows former Section 3-303(b) in providing that the holder takes for value if the instrument is taken in payment of or as security for an antecedent claim, even though there is no extension of time or other concession, and whether or not the claim is due. Subsection (a)(3) applies to any claim against any person; there is no requirement that the claim arise out of contract. In particular the provision is intended to apply to an instrument given in payment of or as security for the debt of a third person, even though no concession is made in return.

5. Subsection (a)(4) and (5) restate former Section 3-303(c). They state generally recognized exceptions to the rule that an executory promise is not value. A negotiable instrument is value because it carries the possibility of negotiation to a holder in due course, after which the party who gives it is obliged to pay. The same reasoning applies to any irrevocable commitment to a third person, such as a letter of credit issued when an instrument is taken.

6. The term "promise" in paragraph (a)(1) is used in the phrase "promise of performance" and for that reason does not have the specialized meaning given that term in Section 3-103(a)(12). See Section 1-201 ("Changes from Former Law"). No inference should be drawn from the decision to use the phrase "promise of performance," although the phrase does include the word "promise," which has the specialized definition set forth in Section 3-103. Indeed, that is true even though "undertaking" is used instead of "promise" in Section 3-104(a)(3). See Section 3-104 comment 1 (explaining the use of the term "undertaking" in Section 3-104 to avoid use of the defined term "promise").

§ 28-3-304. Overdue instrument. — (1) An instrument payable on demand becomes overdue at the earliest of the following times:

(a) On the day after the day demand for payment is duly made; (b) If the instrument is a check, ninety (90) days after its date; or (c) If the instrument is not a check, when the instrument has been outstanding for a period of time after its date which is unreasonably long under the circumstances of the particular case in light of the nature of the instrument and usage of the trade.

(2) With respect to an instrument payable at a definite time the following rules apply: (a) If the principal is payable in installments and a due date has not been accelerated, the instrument becomes overdue upon default under the instrument for nonpayment of an installment, and the instrument remains overdue until the default is cured.

(b) If the principal is not payable in installments and the due date has not been accelerated, the instrument becomes overdue on the day after the due date.

(c) If a due date with respect to principal has been accelerated, the instrument becomes overdue on the day after the accelerated due date.

(3) Unless the due date of principal has been accelerated, an instrument does not become overdue if there is default in payment of interest but no default in payment of principal.

History.

I.C., § 28-3-304, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-304 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

Nonpayment of installment.

Nonpayment of interest installment.

Nonpayment of Installment.

If installment of note was overdue at time it was transferred, purchaser takes whole note as overdue paper and was not holder in due course. GMAC v. Talbott, 39 Idaho 707, 230 P. 30 (1924).

Nonpayment of Interest Installment.

Knowledge by purchaser of overdue installments of interest was a circumstance to be considered in determining his good faith in purchasing note. Winter v. Nobs, 19 Idaho 18, 112 P. 525 (1910).

Mere failure to pay periodical installment of interest would not amount to a dishonor of negotiable instrument and would not render the instrument overdue. However, knowledge by purchaser of overdue installments of interest was a circumstance to be considered in determining his good faith in purchasing note. Winter v. Nobs, 19 Idaho 18, 112 P. 525 (1910).

Mere suspicion that something was wrong did not constitute bad faith. Park v. Johnson, 20 Idaho 548, 119 P. 52 (1911); Continental Nat'l Bank v. Cole, 51 Idaho 140, 3 P.2d 1103 (1931).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 86 et seq.

15A Am. Jur. 2d, Commercial Code, § 97.

Official Comment

1. To be a holder in due course, one must take without notice that an instrument is overdue. Section 3-302(a)(2)(iii). Section 3-304 replaces subsection (3) of former Section 3-304. For the sake of clarity it treats demand and time instruments separately. Subsection (a) applies to demand instruments. A check becomes stale after 90 days.

Under former Section 3-304(3)(c), a holder that took a demand note had notice that it was overdue if it was taken "more than a reasonable length of time after its issue." In substitution for this test, subsection (a)(3) requires

the trier of fact to look at both the circumstances of the particular case and the nature of the instrument and trade usage. Whether a demand note is stale may vary a great deal depending on the facts of the particular case.

2. Subsections (b) and (c) cover time instruments. They follow the distinction made under former Article 3 between defaults in payment of principal and interest. In subsection (b) installment instruments and single payment instruments are treated separately. If an installment is late, the instrument is overdue until the default is cured.

§ 28-3-305. Defenses and claims in recoupment. — (1) Except as stated in subsection (2) of this section, the right to enforce the obligation of a party to pay an instrument is subject to the following:

(a) A defense of the obligor based on (i) infancy of the obligor to the extent it is a defense to a simple contract, (ii) duress, lack of legal capacity or illegality of the transaction which, under other law, nullifies the obligation of the obligor, (iii) fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms, or (iv) discharge of the obligor in insolvency proceedings;

(b) A defense of the obligor stated in another section of this chapter or a defense of the obligor that would be available if the person entitled to enforce the instrument were enforcing a right to payment under a simple contract; and

(c) A claim in recoupment of the obligor against the original payee of the instrument if the claim arose from the transaction that gave rise to the instrument; but the claim of the obligor may be asserted against a transferee of the instrument only to reduce the amount owing on the instrument at the time the action is brought.

(2) The right of a holder in due course to enforce the obligation of a party to pay the instrument is subject to defenses of the obligor stated in subsection (1)(a) of this section, but is not subject to defenses of the obligor stated in subsection (1)(b) of this section or claims in recoupment stated in subsection (1)(c) of this section against a person other than the holder.

(3) Except as stated in subsection (4) of this section, in an action to enforce the obligation of a party to pay the instrument, the obligor may not assert against the person entitled to enforce the instrument a defense, claim in recoupment, or claim to the instrument (section 28-3-306[, Idaho Code]) of another person, but the other person's claim to the instrument may be asserted by the obligor if the other person is joined in the action and personally asserts the claim against the person entitled to enforce the instrument. An obligor is not obliged to pay the instrument if the person

seeking enforcement of the instrument does not have rights of a holder in due course and the obligor proves that the instrument is a lost or stolen instrument.

(4) In an action to enforce the obligation of an accommodation party to pay an instrument, the accommodation party may assert against the person entitled to enforce the instrument any defense or claim in recoupment under subsection (1) of this section that the accommodated party could assert against the person entitled to enforce the instrument, except the defenses of discharge in insolvency proceedings, infancy and lack of legal capacity.

History.

I.C., § 28-3-305, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-305 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in the first sentence in subsection (3) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Arising From the Transaction.

The transaction that gave rise to the promissory note in the instant case was the sale of real property from the owners to the plaintiffs, and the plaintiffs claim in recoupment arose approximately two months after the sale when trees were allegedly removed from the property. Therefore, plaintiffs' claim did not arise from the transaction that gave rise to the instrument but rather from a subsequent timber trespass, and plaintiffs were precluded under subsection (1)(c) of this section from asserting their claim against the assignor of the promissory note, even if she was not a holder in due course. Zener v. Velde, 135 Idaho 352, 17 P.3d 296 (Ct. App. 2000).

Decisions Under Prior Law

Blue Sky Law.

A note given for shares of stock in a corporation not complying with the Blue Sky Law was not void from inception in the absence of such a provision in the statutes and illegality of consideration was not a defense against a bona fide holder. Butte Mach. Co. v. Jeppesen, 41 Idaho 642, 241 P. 36 (1925); Evans v. Wood, 41 Idaho 679, 241 P. 609 (1925); McCornick & Co. v. Tolmie Bros., 46 Idaho 544, 269 P. 96 (1928).

Conditional Delivery.

Defense of conditional delivery of negotiable instrument was good against third person, unless latter can show that he is holder in due course and without notice. First Nat'l Bank v. Campbell, 39 Idaho 736, 230 P. 43 (1924).

Party setting up defense of conditional delivery of promissory note had burden of proving that there was no delivery so as to give effect to instrument. New England Nat'l Bank v. Hubbell, 41 Idaho 129, 238 P. 308 (1925); Bow v. R. & N. Oil Gas Co., 43 Idaho 80, 251 P. 295 (1926).

Whether plaintiff had sufficient knowledge of conditional delivery, as to constitute bad faith in acceptance of note, was question for jury. California Jewelry Co. v. McDonald, 54 Idaho 248, 30 P.2d 778 (1934).

Defenses.

In action on promissory notes allegedly given in payment for the purchase of land in Colorado where defendant contended that the transaction was null and void, the trial court did not err in limiting defendants to the defense pleaded under a provision of former law. Brownlow v. Aman, 740 F.2d 1476 (10th Cir. 1984).

Evidence.

In action on note by innocent purchaser, it was not error for the trial court to exclude evidence offered by the defendants in form of a stock certificate to corroborate their testimony denying execution of the note sued on. Rosnagle v. Armstrong, 17 Idaho 246, 105 P. 216 (1909).

Failure of Consideration.

Failure of consideration was not available against a bona fide purchaser. Whittlesey v. Drake, 43 Idaho 623, 253 P. 621 (1927); Wright v. Gerber, 46 Idaho 476, 269 P. 85 (1928).

Where trade acceptance arising from purchase of goods from drawer failed to disclose whether the goods had been delivered, since the acceptor unqualifiedly promised to pay without reference to future delivery, he could not plead nondelivery as a justification for refusal to pay the acceptance at maturity. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

Fraud.

Where indorser of check was present during transaction and heard certain representations made by payee which later proved to be fraudulent, such indorsee was an innocent purchaser since he had no knowledge of the fraud intended by the payee. Nelson v. Hudgel, 23 Idaho 327, 130 P. 85 (1913).

As a general rule, the fact that a negotiable instrument was obtained by fraud or false representations was not available as a defense against a bona fide purchaser. Southwest Nat'l Bank v. Baker, 23 Idaho 428, 130 P. 799 (1913); Southwest Nat'l Bank v. Lindsley, 29 Idaho 343, 158 P. 1082 (1916); First Nat'l Bank v. Pond, 39 Idaho 770, 230 P. 344 (1924); Wright v. Gerber, 46 Idaho 476, 269 P. 85 (1928).

Holder in Due Course.

The promissory note itself showed that it was complete and regular upon its face, and the proof shows: (1) that the plaintiff became the holder of the note before it was due and without notice that it had previously been dishonored; (2) that he took it in good faith and for value; (3) that at the time he purchased it he had no notice of any infirmity in the instrument or defect in the title. He was, therefore, a holder in due course under former law; thus, he held promissory note free from any defects of title of prior parties, and free from defenses available to prior parties among themselves, and may enforce the payment of the instrument for the full amount thereof against the parties liable thereon. Burdell v. Nereson, 28 Idaho 129, 152 P. 576 (1915).

Nondelivery of Note.

Evidence herein amply sustained contention that promissory note was never delivered. First Trust & Sav. Bank v. Randall, 59 Idaho 705, 89 P.2d 741 (1939).

Parol Evidence.

Parol evidence was admissible in a suit between original parties to show that note was never delivered as a present contract. Burke v. Dulaney, 153 U.S. 228, 14 S. Ct. 816, 38 L. Ed. 698 (1894).

Parol evidence was admissible to show that delivery of instrument was conditional. First Nat'l Bank v. Campbell, 39 Idaho 736, 230 P. 43 (1924).

Where there was no condition attached to delivery of note, parol evidence, that accommodated party assured maker that he would not be required to pay it, should not be allowed, as it tended to vary terms of written contract. Central Bank v. Perkins, 43 Idaho 310, 251 P. 627 (1926).

Want of Consideration.

Want of consideration for a negotiable instrument was no defense against a bona fide purchaser. Southwest Nat'l Bank v. Baker, 23 Idaho 428, 130 P. 799 (1913).

RESEARCH REFERENCES

Am. Jur. 2d. — 11, 12 Am. Jur. 2d, Bills and Notes, § 505 et seq.

ALR. — Fraud in the inducement and fraud in the factum as defenses under UCC § 3-305 against holder in due course. 78 A.L.R.3d 1020.

Duress, incapacity, illegality, or similar defense rendering obligation a nullity as affecting enforceability of negotiable instrument against holder in due course under UCC [rev] § 3-305(a)(1)(ii). 89 A.L.R.5th 577.

Official Comment

1. Subsection (a) states the defenses to the obligation of a party to pay the instrument. Subsection (a)(1) states the "real defenses" that may be asserted against any person entitled to enforce the instrument.

Subsection (a)(1)(i) allows assertion of the defense of infancy against a holder in due course, even though the effect of the defense is to render the instrument voidable but not void. The policy is one of protection of the infant even at the expense of occasional loss to an innocent purchaser. No attempt is made to state when infancy is available as a defense or the conditions under which it may be asserted. In some jurisdictions it is held that an infant cannot rescind the transaction or set up the defense unless the holder is restored to the position held before the instrument was taken which, in the case of a holder in due course, is normally impossible. In other states an infant who has misrepresented age may be estopped to assert infancy. Such questions are left to other law, as an integral part of the policy of each state as to the protection of infants.

Subsection (a)(1)(ii) covers mental incompetence, guardianship, ultra vires acts or lack of corporate capacity to do business, or any other incapacity apart from infancy. Such incapacity is largely statutory. Its existence and effect is left to the law of each state. If under the state law the effect is to render the obligation of the instrument entirely null and void, the defense may be asserted against a holder in due course. If the effect is merely to render the obligation voidable at the election of the obligor, the defense is cut off.

Duress, which is also covered by subsection (a)(ii), is a matter of degree. An instrument signed at the point of a gun is void, even in the hands of a holder in due course. One signed under threat to prosecute the son of the maker for theft may be merely voidable, so that the defense is cut off. Illegality is most frequently a matter of gambling or usury, but may arise in

other forms under a variety of statutes. The statutes differ in their provisions and the interpretations given them. They are primarily a matter of local concern and local policy. All such matters are therefore left to the local law. If under that law the effect of the duress or the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

Subsection (a)(1)(iii) refers to "real" or "essential" fraud, sometimes called fraud in the essence or fraud in the factum, as effective against a holder in due course. The common illustration is that of the maker who is tricked into signing a note in the belief that it is merely a receipt or some other document. The theory of the defense is that the signature on the instrument is ineffective because the signer did not intend to sign such an instrument at all. Under this provision the defense extends to an instrument signed with knowledge that it is a negotiable instrument, but without knowledge of its essential terms. The test of the defense is that of excusable ignorance of the contents of the writing signed. The party must not only have been in ignorance, but must also have had no reasonable opportunity to obtain knowledge. In determining what is a reasonable opportunity all relevant factors are to be taken into account, including the intelligence, education, business experience, and ability to read or understand English of the signer. Also relevant is the nature of the representations that were made, whether the signer had good reason to rely on the representations or to have confidence in the person making them, the presence or absence of any third person who might read or explain the instrument to the signer, or any other possibility of obtaining independent information, and the apparent necessity, or lack of it, for acting without delay. Unless the misrepresentation meets this test, the defense is cut off by a holder in due course.

Subsection (a)(1)(iv) states specifically that the defense of discharge in insolvency proceedings is not cut off when the instrument is purchased by a holder in due course. "Insolvency proceedings" is defined in Section 1-201(22) and it includes bankruptcy whether or not the debtor is insolvent. Subsection (2)(e) of former Section 3-305 is omitted. The substance of that provision is stated in Section 3-601(b).

2. Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a holder in due course. These defenses comprise those

specifically stated in Article 3 and those based on common law contract principles. Article 3 defenses are nonissuance of the instrument, conditional issuance, and issuance for a special purpose (Section 3-105(b)); failure to countersign a traveler's check (Section 3-106(c)); modification of the obligation by a separate agreement (Section 3-117); payment that violates a restrictive indorsement (Section 3-206(f)); instruments issued without consideration or for which promised performance has not been given (Section 3-303(b)), and breach of warranty when a draft is accepted (Section 3-417(b)). The most prevalent common law defenses are fraud, misrepresentation or mistake in the issuance of the instrument. In most cases the holder in due course will be an immediate or remote transferee of the payee of the instrument. In most cases the holder-in-due-course doctrine is irrelevant if defenses are being asserted against the payee of the instrument, but in a small number of cases the payee of the instrument may be a holder in due course. Those cases are discussed in Comment 4 to Section 3-302.

Assume Buyer issues a note to Seller in payment of the price of goods that Seller fraudulently promises to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a holder in due course, Holder is not subject to Buyer's defense of fraud. But in some cases an original party to the instrument is a holder in due course. For example, Buyer fraudulently induces Bank to issue a cashier's check to the order of Seller. The check is delivered by Bank to Seller, who has no notice of the fraud. Seller can be a holder in due course and can take the check free of Bank's defense of fraud. This case is discussed as Case #1 in Comment 4 to Section 3-302. Former Section 3-305 stated that a holder in due course takes free of defenses of "any party to the instrument with whom the holder has not dealt." The meaning of this language was not at all clear and if read literally could have produced the wrong result. In the hypothetical case, it could be argued that Seller "dealt" with Bank because Bank delivered the check to Seller. But it is clear that Seller should take free of Bank's defense against Buyer regardless of whether Seller took delivery of the check from Buyer or from Bank. The quoted language is not included in Section 3-305. It is not necessary. If Buyer issues an instrument to Seller and Buyer has a defense against Seller, that defense can obviously be asserted. Buyer and Seller are the only people involved. The holder-in-due-course doctrine has no relevance. The doctrine

applies only to cases in which more than two parties are involved. Its essence is that the holder in due course does not have to suffer the consequences of a defense of the obligor on the instrument that arose from an occurrence with a third party.

3. Subsection (a)(3) is concerned with claims in recoupment which can be illustrated by the following example. Buyer issues a note to the order of Seller in exchange for a promise of Seller to deliver specified equipment. If Seller fails to deliver the equipment or delivers equipment that is rightfully rejected, Buyer has a defense to the note because the performance that was the consideration for the note was not rendered. Section 3-303(b). This defense is included in Section 3-305(a)(2). That defense can always be asserted against Seller. This result is the same as that reached under former Section 3-408.

But suppose Seller delivered the promised equipment and it was accepted by Buyer. The equipment, however, was defective. Buyer retained the equipment and incurred expenses with respect to its repair. In this case, Buyer does not have a defense under Section 3-303(b). Seller delivered the equipment and the equipment was accepted. Under Article 2, Buyer is obliged to pay the price of the equipment which is represented by the note. But Buyer may have a claim against Seller for breach of warranty. If Buyer has a warranty claim, the claim may be asserted against Seller as a counterclaim or as a claim in recoupment to reduce the amount owing on the note. It is not relevant whether Seller is or is not a holder in due course of the note or whether Seller knew or had notice that Buyer had the warranty claim. It is obvious that holder-in-due-course doctrine cannot be used to allow Seller to cut off a warranty claim that Buyer has against Seller. Subsection (b) specifically covers this point by stating that a holder in due course is not subject to a "claim in recoupment *** against a person other than the holder."

Suppose Seller negotiates the note to Holder. If Holder had notice of Buyer's warranty claim at the time the note was negotiated to Holder, Holder is not a holder in due course (Section 3-302(a)(2)(iv)) and Buyer may assert the claim against Holder (Section 3-305(a)(3)) but only as a claim in recoupment, *i.e.* to reduce the amount owed on the note. If the warranty claim is $1,000 and the unpaid note is $10,000, Buyer owes $9,000 to Holder. If the warranty claim is more than the unpaid amount of

the note, Buyer owes nothing to Holder, but Buyer cannot recover the unpaid amount of the warranty claim from Holder. If Buyer had already partially paid the note, Buyer is not entitled to recover the amounts paid. The claim can be used only as an offset to amounts owing on the note. If Holder had no notice of Buyer's claim and otherwise qualifies as a holder in due course, Buyer may not assert the claim against Holder. Section 3-305(b).

The result under Section 3-305 is consistent with the result reached under former Article 3, but the rules for reaching the result are stated differently. Under former Article 3 Buyer could assert rights against Holder only if Holder was not a holder in due course, and Holder's status depended upon whether Holder had notice of a defense by Buyer. Courts have held that Holder had that notice if Holder had notice of Buyer's warranty claim. The rationale under former Article 3 was "failure of consideration." This rationale does not distinguish between cases in which the seller fails to perform and those in which the buyer accepts the performance of seller but makes a claim against the seller because the performance is faulty. The term "failure of consideration" is subject to varying interpretations and is not used in Article 3. The use of the term "claim in recoupment" in Section 3-305(a)(3) is a more precise statement of the nature of Buyer's right against Holder. The use of the term does not change the law because the treatment of a defense under subsection (a)(2) and a claim in recoupment under subsection (a)(3) is essentially the same.

Under former Article 3, case law was divided on the issue of the extent to which an obligor on a note could assert against a transferee who is not a holder in due course a debt or other claim that the obligor had against the original payee of the instrument. Some courts limited claims to those that arose in the transaction that gave rise to the note. This is the approach taken in Section 3-305(a)(3). Other courts allowed the obligor on the note to use any debt or other claim, no matter how unrelated to the note, to offset the amount owed on the note. Under current judicial authority and non-UCC statutory law, there will be many cases in which a transferee of a note arising from a sale transaction will not qualify as a holder in due course. For example, applicable law may require the use of a note to which there cannot be a holder in due course. See Section 3-106(d) and Comment 3 to Section 3-106. It is reasonable to provide that the buyer should not be denied the

right to assert claims arising out of the sale transaction. Subsection (a)(3) is based on the belief that it is not reasonable to require the transferee to bear the risk that wholly unrelated claims may also be asserted. The determination of whether a claim arose from the transaction that gave rise to the instrument is determined by law other than this Article and thus may vary as local law varies.

4. Subsection (c) concerns claims and defenses of a person other than the obligor on the instrument. It applies principally to cases in which an obligation is paid with the instrument of a third person. For example, Buyer buys goods from Seller and negotiates to Seller a cashier's check issued by Bank in payment of the price. Shortly after delivering the check to Seller, Buyer learns that Seller had defrauded Buyer in the sale transaction. Seller may enforce the check against Bank even though Seller is not a holder in due course. Bank has no defense to its obligation to pay the check and it may not assert defenses, claims in recoupment, or claims to the instrument of Buyer, except to the extent permitted by the "but" clause of the first sentence of subsection (c). Buyer may have a claim to the instrument under Section 3-306 based on a right to rescind the negotiation to Seller because of Seller's fraud. Section 3-202(b) and Comment 2 to Section 3-201. Bank cannot assert that claim unless Buyer is joined in the action in which Seller is trying to enforce payment of the check. In that case Bank may pay the amount of the check into court and the court will decide whether that amount belongs to Buyer or Seller. The last sentence of subsection (c) allows the issuer of an instrument such as a cashier's check to refuse payment in the rare case in which the issuer can prove that the instrument is a lost or stolen instrument and the person seeking enforcement does not have rights of a holder in due course.

5. Subsection (d) applies to instruments signed for accommodation (Section 3-419) and this subsection equates the obligation of the accommodation party to that of the accommodated party. The accommodation party can assert whatever defense or claim the accommodated party had against the person enforcing the instrument. The only exceptions are discharge in bankruptcy, infancy and lack of capacity. The same rule does not apply to an indorsement by a holder of the instrument in negotiating the instrument. The indorser, as transferor, makes a warranty to the indorsee, as transferee, that no defense or claim in

recoupment is good against the indorser. Section 3-416(a)(4). Thus, if the indorsee sues the indorser because of dishonor of the instrument, the indorser may not assert the defense or claim in recoupment of the maker or drawer against the indorsee.

Section 3-305(d) must be read in conjunction with Section 3-605, which provides rules (usually referred to as suretyship defenses) for determining when the obligation of an accommodation party is discharged, in whole or in part, because of some act or omission of a person entitled to enforce the instrument. To the extent a rule stated in Section 3-605 is inconsistent with Section 3-305(d), the Section 3-605 rule governs. For example, Section 3-605(a) provides rules for determining when and to what extent a discharge of the accommodated party under Section 3-604 will discharge the accommodation party. As explained in Comment 2 to Section 3-605, discharge of the accommodated party is normally part of a settlement under which the holder of a note accepts partial payment from an accommodated party who is financially unable to pay the entire amount of the note. If the holder then brings an action against the accommodation party to recover the remaining unpaid amount of the note, the accommodation party cannot use Section 3-305(d) to nullify Section 3-605(a) by asserting the discharge of the accommodated party as a defense. On the other hand, suppose the accommodated party is a buyer of goods who issued the note to the seller who took the note for the buyer's obligation to pay for the goods. Suppose the buyer has a claim for breach of warranty with respect to the goods against the seller and the warranty claim may be asserted against the holder of the note. The warranty claim is a claim in recoupment. If the holder and the accommodated party reach a settlement under which the holder accepts payment less than the amount of the note in full satisfaction of the note and the warranty claim, the accommodation party could defend an action on the note by the holder by asserting the accord and satisfaction under Section 3-305(d). There is no conflict with Section 3-605(a) because that provision is not intended to apply to settlement of disputed claims.

§ 28-3-306. Claims to an instrument. — A person taking an instrument, other than a person having rights of a holder in due course, is subject to a claim of a property or possessory right in the instrument or its proceeds, including a claim to rescind a negotiation and to recover the instrument or its proceeds. A person having rights of a holder in due course takes free of the claim to the instrument.

History.

I.C., § 28-3-306, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-306 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

Subject to.

Weight of evidence for jury.

Burden of Proof.

Where defendant pleaded and proved note was procured by fraud, it was incumbent upon plaintiff to show affirmatively that he was holder in due course. Winter v. Nobs, 19 Idaho 18, 112 P. 525 (1910); Shellenberger v. Nourse, 20 Idaho 323, 118 P. 508 (1911); Vaughn v. Johnson, 20 Idaho 669, 119 P. 879 (1911); Brown v. Miller, 22 Idaho 307, 125 P. 981 (1912); Altschul v. Rogers, 22 Idaho 512, 126 P. 1048 (1912); First Nat'l Bank v. Hall, 31 Idaho 167, 169 P. 936 (1918); Wright v. Spencer, 39 Idaho 60, 226 P. 173 (1924); First Nat'l Bank v. Pond, 39 Idaho 770, 230 P. 344 (1924); Utah State Nat'l Bank v. Stringer, 44 Idaho 599, 258 P. 522 (1927).

Where it was shown that original instrument was obtained by fraud, burden rests upon subsequent holder to prove that he acquired title as holder in due course, and that he took instrument in good faith and for value with no notice of defect in title. Guthrie v. Ensign, 36 Idaho 673, 213 P. 354 (1923).

Where evidence shows conditional delivery of promissory note, burden was on holder to show that he took without notice of such defect. First Nat'l Bank v. Campbell, 39 Idaho 736, 230 P. 43 (1924).

Proof that the consideration for a note was securities issued in violation of the Blue Sky Law and, therefore, illegal shifts the burden to the holder to show that he was an owner in due course. Ashley & Rumelin v. Brady, 41 Idaho 160, 238 P. 314 (1925).

Title to note having been defective under former law, plaintiff in suit thereon had burden of proving that it was a holder in due course. Ashley State Bank v. Hood, 47 Idaho 780, 279 P. 418 (1929).

Proof of noncompliance was admissible and casts on the holder the duty of showing that he was a holder in due course. Continental Nat'l Bank v. Cole, 51 Idaho 140, 3 P.2d 1103 (1931).

Delivery.

Contingent or conditional delivery was a defense to an instrument in the hands of a holder not in due course. Whittlesey v. Drake, 43 Idaho 623, 253

P. 621 (1927).

Where a defense of delivery for a special purpose was raised under former law, parol evidence was admissible to prove the terms of the underlying transaction. Ventures, Inc. v. Jones, 101 Idaho 837, 623 P.2d 145 (1981).

Where plaintiff took promissory notes which were five years overdue on their face, it could not be a holder in due course and was subject to the defenses under former section, including the defense of delivery for a special purpose; thus, where defendants carried their burden under another former section of showing that the notes had been given and received for the special purpose of interim security and were to serve only as additional security until substitute security could be provided in the form of a mortgage from the plaintiff, the trial court did not err in holding that, upon plaintiff giving substitute security in the form of a mortgage, any obligation on the notes was extinguished and that the transfer of the notes did not transfer an enforceable obligation. Ventures, Inc. v. Jones, 101 Idaho 837, 623 P.2d 145 (1981).

Failure of Consideration.

Want or failure of consideration was a good defense against a holder not in due course. Shellenberger v. Nourse, 20 Idaho 323, 118 P. 508 (1911); Whittlesey v. Drake, 43 Idaho 623, 253 P. 621 (1927).

Partial failure of consideration was no defense unless there was a rescission and return of the consideration received. Pioneer Bank & Trust Co. v. MacNab, 41 Idaho 146, 238 P. 295 (1925).

Where consideration for giving of note was promise to construct drainage system under supervision of an engineer, the consideration failed when an ineffectual system was constructed without engineer's advice. Sheppard Inv. Co. v. Roscoe, 48 Idaho 405, 283 P. 519 (1929).

Fraud.

Fraud was available as a defense against a holder not in due course. Shellenberger v. Nourse, 20 Idaho 323, 118 P. 508 (1911).

Fraud was a valid defense between the parties. Brown v. Miller, 22 Idaho 307, 125 P. 981 (1912).

In pleading fraud as a defense, injury to the maker of the note resulting from the fraud must have been averred. Frank v. Davis, 34 Idaho 678, 203 P. 287 (1921).

Where a plaintiff sues on a note proved by defendant to have been procured by fraud, plaintiff must have affirmatively shown that he was a holder in due course. Wright v. Spencer, 39 Idaho 60, 226 P. 173 (1924).

In an action on a promissory note, given in payment for a correspondence course, the evidence of defendant that note was procured by fraudulent representations as to the course was sufficient to sustain a directed verdict. Idaho State Merchants' Protective Ass'n v. Roche, 53 Idaho 115, 22 P.2d 136 (1933).

Gambling Debt.

A check given, with knowledge of the plaintiff, for the purpose of procuring money with which to gamble, could not be recovered on by plaintiff, but it was otherwise if the check was regular on its face and the plaintiff was a holder without notice. Camas Prairie State Bank v. Newman, 15 Idaho 719, 99 P. 833 (1909).

Good Faith.

The evidence in the following cases was held to show a purchase in good faith. Vaughan v. Brandt, 21 Idaho 628, 123 P. 591 (1912); Nelson v. Hudgel, 23 Idaho 327, 130 P. 85 (1913); Burdell v. Nereson, 28 Idaho 129, 152 P. 576 (1915); Harris v. Sainsbury, 50 Idaho 502, 298 P. 360 (1931).

Illegal Consideration.

Total or partial illegality of consideration was a defense against a holder not in due course. Ashley State Bank v. Hood, 47 Idaho 780, 279 P. 418 (1929).

Insufficient Consideration.

Inadequacy of consideration was no defense to action on promissory note unless there was fraud also on part of promisee. Harshbarger v. Eby, 28 Idaho 753, 156 P. 619 (1916).

Lack of Consideration.

The maker of a note could not defend on ground of lack of consideration where his answer admits receiving and retaining a part of the consideration. Daniels v. Englehart, 18 Idaho 548, 111 P. 3 (1910).

Where a lack of consideration was urged as defense, questions of amount of wheat delivered to plaintiff, value thereof, price credited to defendant, and nature of the agreement are for jury where evidence was conflicting. Colorado Milling & Elevator Co. v. Proctor, 58 Idaho 578, 76 P.2d 438 (1938).

Notice.

Transferee of note, regular on its face, need not have inquired whether payee had complied with state laws, unless he had notice of facts putting him on inquiry. Chesney v. Bodily, 50 Idaho 597, 298 P. 937 (1931).

Pleading and Practice.

Where defendant denied that plaintiff was a bona fide holder of a note, but offered no evidence to substantiate his denial, and the evidence of the plaintiff tended to prove that men of ordinary intelligence might have drawn different conclusions from such evidence, the court might have refused to instruct a verdict for the plaintiff. Winter v. Hutchins, 20 Idaho 749, 119 P. 883 (1911).

Where no defense was alleged, the sufficiency of the pleading as to the bona fides of the holder was immaterial. Colorado Nat'l Bank v. Meadow Creek Livestock Co., 36 Idaho 509, 211 P. 1076 (1922).

There need have been no allegation charging the holder of a note with notice of defects in order to permit evidence of such fact to be introduced. Chesney v. Bodily, 50 Idaho 597, 298 P. 937 (1931).

Presumptions.

Evidence must have been sufficient to show that title of indorser of instrument was defective, so as to remove presumption that every holder is deemed prima facie to be holder in due course. Pacific States Automotive Fin. Corp. v. Addison, 45 Idaho 270, 261 P. 683 (1927).

One suing on trade acceptances was presumed to be holder in due course. Harris v. Sainsbury, 50 Idaho 502, 298 P. 360 (1931).

Subject to.

A party who was not a holder in due course and who takes a promissory note by assignment takes the note "subject to" all valid claims to it on the part of any person and all defenses of any party. The effect given to the words "subject to" was that the obligor on the note may assert setoffs against it or may have defenses that make the note uncollectible, but the obligor cannot make affirmative claims for damages against the note assignee based upon some tort or breach of contract by the original payee. Murr v. Selag Corp., 113 Idaho 773, 747 P.2d 1302 (Ct. App. 1987).

Weight of Evidence for Jury.

Whether plaintiff had satisfactorily met burden of proof to make good his claim to be innocent purchaser was a question of fact for jury and is subject to the same rule as to its weight and sufficiency as any other fact in the case (*Winter v. Nobs*, 19 Idaho 18, 112 P. 525 (1910), save where testimony was not only consistent with the good faith of purchase, but was such that no fair-minded person could draw any other inference therefrom. Southwest Nat'l Bank v. Lindsley, 29 Idaho 343, 158 P. 1082 (1916).

Where evidence was conflicting or different inferences might have been drawn therefrom, question whether plaintiff was holder in due course was one for jury, provided evidence was sufficient to warrant submission of question to jury. GMAC v. Talbott, 39 Idaho 707, 230 P. 30 (1924).

Verdict may have been directed, even where only testimony relied on by holder of note was his own or his agent's, if they are unimpeached, uncontradicted and no contrary inference could have been drawn from facts and circumstances shown by all the evidence. First Nat'l Bank v. Pond, 39 Idaho 770, 230 P. 344 (1924).

Official Comment

This section expands on the reference to "claims to" the instrument mentioned in former Sections 3-305 and 3-306. Claims covered by the section include not only claims to ownership but also any other claim of a property or possessory right. It includes the claim to a lien or the claim of a person in rightful possession of an instrument who was wrongfully deprived of possession. Also included is a claim based on Section 3-202(b) for

rescission of a negotiation of the instrument by the claimant. Claims to an instrument under Section 3-306 are different from claims in recoupment referred to in Section 3-305(a)(3). The rule of this section is similar to the rule of Article 30(2) of the Convention on International Bills of Exchange and International Promissory Notes.

§ 28-3-307. Proof of signatures and status as holder in due course. — (1) In an action with respect to an instrument, the authenticity of, and authority to make, each signature on the instrument is admitted unless specifically denied in the pleadings. If the validity of a signature is denied in the pleadings, the burden of establishing validity is on the person claiming validity, but the signature is presumed to be authentic and authorized unless the action is to enforce the liability of the purported signer and the signer is dead or incompetent at the time of trial of the issue of validity of the signature. If an action to enforce the instrument is brought against a person as the undisclosed principal of a person who signed the instrument as a party to the instrument, the plaintiff has the burden of establishing that the defendant is liable on the instrument as a represented person under section 28-3-402(1)[, Idaho Code].

(2) If the validity of signatures is admitted or proved and there is compliance with subsection (1) of this section, a plaintiff producing the instrument is entitled to payment if the plaintiff proves entitlement to enforce the instrument under section 28-3-301[, Idaho Code], unless the defendant proves a defense or claim in recoupment. If a defense or claim in recoupment is proved, the right to payment of the plaintiff is subject to the defense or claim, except to the extent the plaintiff proves that the plaintiff has rights of a holder in due course which are not subject to the defense or claim.

History.

I.C., § 28-3-307, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-307 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

Since the Idaho legislature in enacting Uniform Commercial Code — Negotiable Instruments (S.L. 1993, ch. 288) did not adopt § 3-307 of the uniform version, §§ 28-3-307 to 28-3-111 of the Idaho Code correspond to §§ 3-308 to 3-312 of the uniform version. Thus, references to Section 3-308 in the Official Comment, below, are actually to this section.

The bracketed insertions in subsections (1) and (2) were added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 597 et seq.

Official Comment

1. Section 3-308 is a modification of former Section 3-307. The first two sentences of subsection (a) are a restatement of former Section 3-307(1). The purpose of the requirement of a specific denial in the pleadings is to give the plaintiff notice of the defendant's claim of forgery or lack of authority as to the particular signature, and to afford the plaintiff an opportunity to investigate and obtain evidence. If local rules of pleading permit, the denial may be on information and belief, or it may be a denial of knowledge or information sufficient to form a belief. It need not be under oath unless the local statutes or rules require verification. In the absence of such specific denial the signature stands admitted, and is not in issue. Nothing in this section is intended, however, to prevent amendment of the pleading in a proper case.

The question of the burden of establishing the signature arises only when it has been put in issue by specific denial. "Burden of establishing" is defined in Section 1-201. The burden is on the party claiming under the signature, but the signature is presumed to be authentic and authorized except as stated in the second sentence of subsection (a). "Presumed" is defined in Section 1-201 and means that until some evidence is introduced which would support a finding that the signature is forged or unauthorized, the plaintiff is not required to prove that it is valid. The presumption rests upon the fact that in ordinary experience forged or unauthorized signatures are very uncommon, and normally any evidence is within the control of, or more accessible to, the defendant. The defendant is therefore required to

make some sufficient showing of the grounds for the denial before the plaintiff is required to introduce evidence. The defendant's evidence need not be sufficient to require a directed verdict, but it must be enough to support the denial by permitting a finding in the defendant's favor. Until introduction of such evidence the presumption requires a finding for the plaintiff. Once such evidence is introduced the burden of establishing the signature by a preponderance of the total evidence is on the plaintiff. The presumption does not arise if the action is to enforce the obligation of a purported signer who has died or become incompetent before the evidence is required, and so is disabled from obtaining or introducing it. "Action" is defined in Section 1-201 and includes a claim asserted against the estate of a deceased or an incompetent.

The last sentence of subsection (a) is a new provision that is necessary to take into account Section 3-402(a) that allows an undisclosed principal to be liable on an instrument signed by an authorized representative. In that case the person enforcing the instrument must prove that the undisclosed principal is liable.

2. Subsection (b) restates former Section 3-307(2) and (3). Once signatures are proved or admitted a holder, by mere production of the instrument, proves "entitlement to enforce the instrument" because under Section 3-301 a holder is a person entitled to enforce the instrument. Any other person in possession of an instrument may recover only if that person has the rights of a holder. Section 3-301. That person must prove a transfer giving that person such rights under Section 3-203(b) or that such rights were obtained by subrogation or succession.

If a plaintiff producing the instrument proves entitlement to enforce the instrument, either as a holder or a person with rights of a holder, the plaintiff is entitled to recovery unless the defendant proves a defense or claim in recoupment. Until proof of a defense or claim in recoupment is made, the issue as to whether the plaintiff has rights of a holder in due course does not arise. In the absence of a defense or claim in recoupment, any person entitled to enforce the instrument is entitled to recover. If a defense or claim in recoupment is proved, the plaintiff may seek to cut off the defense or claim in recoupment by proving that the plaintiff is a holder in due course or that the plaintiff has rights of a holder in due course under

Section 3-203(b) or by subrogation or succession. All elements of Section 3-302(a) must be proved.

Nothing in this section is intended to say that the plaintiff must necessarily prove rights as a holder in due course. The plaintiff may elect to introduce no further evidence, in which case a verdict may be directed for the plaintiff or the defendant, or the issue of the defense or claim in recoupment may be left to the trier of fact, according to the weight and sufficiency of the defendant's evidence. The plaintiff may elect to rebut the defense or claim in recoupment by proof to the contrary, in which case a verdict may be directed for either party or the issue may be for the trier of fact. Subsection (b) means only that if the plaintiff claims the rights of a holder in due course against the defense or claim in recoupment, the plaintiff has the burden of proof on that issue.

§ 28-3-308. Enforcement of lost, destroyed, or stolen instrument. — (1) A person not in possession of an instrument is entitled to enforce the instrument if (i) the person was in possession of the instrument and entitled to enforce it when loss of possession occurred, (ii) the loss of possession was not the result of a transfer by the person or a lawful seizure, and (iii) the person cannot reasonably obtain possession of the instrument because the instrument was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(2) A person seeking enforcement of an instrument under subsection (1) of this section must prove the terms of the instrument and the person's right to enforce the instrument. If that proof is made, the provisions of this section apply to the case as if the person seeking enforcement had produced the instrument. The court may not enter judgment in favor of the person seeking enforcement unless it finds that the person required to pay the instrument is adequately protected against loss that might occur by reason of a claim by another person to enforce the instrument. Adequate protection may be provided by any reasonable means.

History.

I.C., § 28-3-308, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Compiler's Notes.

Since the Idaho legislature in enacting Uniform Commercial Code — Negotiable Instruments (S.L. 1993, ch. 288) did not adopt § 3-307 of the uniform version, §§ 28-3-307 to 28-3-111 of the Idaho Code correspond to §§ 3-308 to 3-312 of the uniform version. Thus references to Section 3-309 in the Official Comment, below, are actually to this section.

Official Comment Section 3-309 is a modification of former Section 3-804. The rights stated are those of "a person entitled to enforce the

instrument" at the time of loss rather than those of an "owner" as in former Section 3-804. Under subsection (b), judgment to enforce the instrument cannot be given unless the court finds that the defendant will be adequately protected against a claim to the instrument by a holder that may appear at some later time. The court is given discretion in determining how adequate protection is to be assured. Former Section 3-804 allowed the court to "require security indemnifying the defendant against loss." Under Section 3-309 adequate protection is a flexible concept. For example, there is substantial risk that a holder in due course may make a demand for payment if the instrument was payable to bearer when it was lost or stolen. On the other hand if the instrument was payable to the person who lost the instrument and that person did not indorse the instrument, no other person could be a holder of the instrument. In some cases there is risk of loss only if there is doubt about whether the facts alleged by the person who lost the instrument are true. Thus, the type of adequate protection that is reasonable in the circumstances may depend on the degree of certainty about the facts in the case.

§ 28-3-309. Effect of instrument on obligation for which taken. — (1) Unless otherwise agreed, if a certified check, cashier's check or teller's check is taken for an obligation, the obligation is discharged to the same extent discharge would result if an amount of money equal to the amount of the instrument were taken in payment of the obligation. Discharge of the obligation does not affect any liability that the obligor may have as an indorser of the instrument.

(2) Unless otherwise agreed and except as provided in subsection (1) of this section, if a note or an uncertified check is taken for an obligation, the obligation is suspended to the same extent the obligation would be discharged if an amount of money equal to the amount of the instrument were taken, and the following rules apply:

(a) In the case of an uncertified check, suspension of the obligation continues until dishonor of the check or until it is paid or certified. Payment or certification of the check results in discharge of the obligation to the extent of the amount of the check.

(b) In the case of a note, suspension of the obligation continues until dishonor of the note or until it is paid. Payment of the note results in discharge of the obligation to the extent of the payment.

(c) Except as provided in subsection (2)(d) of this section, if the check or note is dishonored and the obligee of the obligation for which the instrument was taken is the person entitled to enforce the instrument, the obligee may enforce either the instrument or the obligation. In the case of an instrument of a third person which is negotiated to the obligee by the obligor, discharge of the obligor on the instrument also discharges the obligation.

(d) If the person entitled to enforce the instrument taken for an obligation is a person other than the obligee, the obligee may not enforce the obligation to the extent the obligation is suspended. If the obligee is the person entitled to enforce the instrument but no longer has possession of it because it was lost, stolen, or destroyed, the obligation may not be enforced to the extent of the amount payable on the instrument, and to

that extent the obligee's rights against the obligor are limited to enforcement of the instrument.

(3) If an instrument other than one described in subsection (1) or (2) of this section is taken for an obligation, the effect is (i) that stated in subsection (1) of this section if the instrument is one on which a bank is liable as maker or acceptor, or (ii) that stated in subsection (2) of this section in any other case.

History.

I.C., § 28-3-309, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Compiler's Notes.

Since the Idaho legislature in enacting Uniform Commercial Code — Negotiable Instruments (S.L. 1993, ch. 288) did not adopt § 3-307 of the uniform version, §§ 28-3-307 to 28-3-111 of the Idaho Code correspond to §§ 3-308 to 3-312 of the uniform version. Thus, references to Section 3-310 in the Official Comment, below, are actually to this section.

Official Comment

1. Section 3-310 is a modification of former Section 3-802. As a practical matter, application of former Section 3-802 was limited to cases in which a check or a note was given for an obligation. Subsections (a) and (b) of Section 3-310 are therefore stated in terms of checks and notes in the interests of clarity. Subsection (c) covers the rare cases in which some other instrument is given to pay an obligation.

2. Subsection (a) deals with the case in which a certified check, cashier's check or teller's check is given in payment of an obligation. In that case the obligation is discharged unless there is an agreement to the contrary. Subsection (a) drops the exception in former Section 3-802 for cases in which there is a right of recourse on the instrument against the obligor. Under former Section 3-802(1)(a) the obligation was not discharged if there was a right of recourse on the instrument against the obligor. Subsection (a)

changes this result. The underlying obligation is discharged, but any right of recourse on the instrument is preserved.

3. Subsection (b) concerns cases in which an uncertified check or a note is taken for an obligation. The typical case is that in which a buyer pays for goods or services by giving the seller the buyer's personal check, or in which the buyer signs a note for the purchase price. Subsection (b) also applies to the uncommon cases in which a check or note of a third person is given in payment of the obligation. Subsection (b) preserves the rule under former Section 3-802(1)(b) that the buyer's obligation to pay the price is suspended, but subsection (b) spells out the effect more precisely. If the check or note is dishonored, the seller may sue on either the dishonored instrument or the contract of sale if the seller has possession of the instrument and is the person entitled to enforce it. If the right to enforce the instrument is held by somebody other than the seller, the seller can't enforce the right to payment of the price under the sales contract because that right is represented by the instrument which is enforceable by somebody else. Thus, if the seller sold the note or the check to a holder and has not reacquired it after dishonor, the only right that survives is the right to enforce the instrument.

The last sentence of subsection (b)(3) applies to cases in which an instrument of another person is indorsed over to the obligee in payment of the obligation. For example, Buyer delivers an uncertified personal check of X payable to the order of Buyer to Seller in payment of the price of goods. Buyer indorses the check over to Seller. Buyer is liable on the check as indorser. If Seller neglects to present the check for payment or to deposit it for collection within 30 days of the indorsement, Buyer's liability as indorser is discharged. Section 3-415(e). Under the last sentence of Section 3-310(b)(3) Buyer is also discharged on the obligation to pay for the goods.

4. There was uncertainty concerning the applicability of former Section 3-802 to the case in which the check given for the obligation was stolen from the payee, the payee's signature was forged, and the forger obtained payment. The last sentence of subsection (b)(4) addresses this issue. If the payor bank pays a holder, the drawer is discharged on the underlying obligation because the check was paid. Subsection (b)(1). If the payor bank pays a person not entitled to enforce the instrument, as in the hypothetical case, the suspension of the underlying obligation continues because the

check has not been paid. Section 3-602(a). The payee's cause of action is against the depositary bank or payor bank in conversion under Section 3-420 or against the drawer under Section 3-309. In the latter case, the drawer's obligation under Section 3-414(b) is triggered by dishonor which occurs because the check is unpaid. Presentment for payment to the drawee is excused under Section 3-504(a)(i) and, under Section 3-502(e), dishonor occurs without presentment if the check is not paid. The payee cannot merely ignore the instrument and sue the drawer on the underlying contract. This would impose on the drawer the risk that the check when stolen was indorsed in blank or to bearer.

A similar analysis applies with respect to lost instruments that have not been paid. If a creditor takes a check of the debtor in payment of an obligation, the obligation is suspended under the introductory paragraph of subsection (b). If the creditor then loses the check, what are the creditor's rights? The creditor can request the debtor to issue a new check and in many cases, the debtor will issue a replacement check after stopping payment on the lost check. In that case both the debtor and creditor are protected. But the debtor is not obliged to issue a new check. If the debtor refuses to issue a replacement check, the last sentence of subsection (b)(4) applies. The creditor may not enforce the obligation of debtor for which the check was taken. The creditor may assert only rights on the check. The creditor can proceed under Section 3-309 to enforce the obligation of the debtor, as drawer, to pay the check.

5. Subsection (c) deals with rare cases in which other instruments are taken for obligations. If a bank is the obligor on the instrument, subsection (a) applies and the obligation is discharged. In any other case subsection (b) applies.

§ 28-3-310. Accord and satisfaction by use of instrument. — (1) If a person against whom a claim is asserted proves that (i) that person in good faith tendered an instrument to the claimant as full satisfaction of the claim, (ii) the amount of the claim was unliquidated or subject to a bona fide dispute, and (iii) the claimant obtained payment of the instrument, the following subsections apply.

(2) Unless subsection (3) of this section applies, the claim is discharged if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim.

(3) Subject to subsection (4) of this section, a claim is not discharged under subsection (2) of this section if either of the following applies:

(a) The claimant, if an organization, proves that (i) within a reasonable time before the tender, the claimant sent a conspicuous statement to the person against whom the claim is asserted that communications concerning disputed debts, including an instrument tendered as full satisfaction of a debt, are to be sent to a designated person, office or place, and (ii) the instrument or accompanying communication was not received by that designated person, office, or place.

(b) The claimant, whether or not an organization, proves that within ninety (90) days after payment of the instrument, the claimant tendered repayment of the amount of the instrument to the person against whom the claim is asserted. This paragraph does not apply if the claimant is an organization that sent a statement complying with paragraph (a)(i) of this subsection.

(4) A claim is discharged if the person against whom the claim is asserted proves that within a reasonable time before collection of the instrument was initiated, the claimant, or an agent of the claimant having direct responsibility with respect to the disputed obligation, knew that the instrument was tendered in full satisfaction of the claim.

History.

I.C., § 28-3-310, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Compiler's Notes.

Since the Idaho legislature in enacting Uniform Commercial Code — Negotiable Instruments (S.L. 1993, ch. 288) did not adopt § 3-307 of the uniform version, §§ 28-3-307 to 28-3-111 of the Idaho Code correspond to §§ 3-308 to 3-312 of the uniform version. Thus, references to Section 3-311 in the Official Comment, below are actually to this section.

CASE NOTES

Discharge.

In order for a claim under this section to be discharged, debtor has burden of demonstrating that he, in good faith, tendered an instrument to payee in full satisfaction of the claim; the amount of the claim was unliquidated or subject to a bona fide dispute; payee obtained payment of the instrument; and the instrument contained a conspicuous statement to the effect that it was tendered as full satisfaction of the claim. Holley v. Holley, 128 Idaho 503, 915 P.2d 733 (Ct. App. 1996).

Elements.

The elements of an accord and satisfaction, when a party is seeking to satisfy a debt by a negotiable instrument, are: (1) the obligor in good faith tendered an instrument to the obligee as full satisfaction of the claim; (2) the amount of the claim was unliquidated or subject to a bona fide dispute;

(3) the obligee obtained payment of the instrument; and (4) the instrument contained a conspicuous statement to the effect that it was tendered as full satisfaction of the claim. Watkins Co., LLC v. Storms, 152 Idaho 531, 272 P.3d 503 (2012).

Illustrative Cases.

Where plaintiffs loaned defendant $20,000, plaintiffs later took over defendant's farm repair business and agreed not to pursue the note if defendant would leave his tools and equipment on the business premises. When plaintiffs sued defendant to collect on the note, the trial court correctly held that defendant had proven a valid accord and satisfaction. Shore v. Peterson, 146 Idaho 903, 204 P.3d 1114 (2009).

In an action by a landlord to enforce a commercial lease after tenants failed to timely pay the rent, the trial court properly held that payment on three-day notices from the landlord to pay rent or quit the premises did not establish an accord and satisfaction; the record did not show, nor did the tenants present, any evidence that the parties agreed that payment on the notices would be a full satisfaction of the debt. Watkins Co., LLC v. Storms, 152 Idaho 531, 272 P.3d 503 (2012).

No Discharge.

Check was not a valid accord and satisfaction where there was no plain statement that the check was tendered as full satisfaction of the claim, the debt appellant sought to avoid was not due at the time the check was remitted. Strother v. Strother, 136 Idaho 864, 41 P.3d 750 (Ct. App. 2002).

Satisfaction.

— Intent.

Under this section the "intent" of the payee in accepting a check is no longer a crucial factor, but instead is irrelevant. Holley v. Holley, 128 Idaho 503, 915 P.2d 733 (Ct. App. 1996).

— "Paid-In-Full."

Ex-wife's negotiation of ex-husband's "paid-in-full" check constituted satisfaction of the 1988 accord, even though ex-wife obliterated ex-husband's notation that check was in full settlement of claim prior to

negotiating check. Holley v. Holley, 128 Idaho 503, 915 P.2d 733 (Ct. App. 1996).

Official Comment

1. This section deals with an informal method of dispute resolution carried out by use of a negotiable instrument. In the typical case there is a dispute concerning the amount that is owed on a claim.

> **Case #1.** The claim is for the price of goods or services sold to a consumer who asserts that he or she is not obliged to pay the full price for which the consumer was billed because of a defect or breach of warranty with respect to the goods or services.
>
> **Case #2.** A claim is made on an insurance policy. The insurance company alleges that it is not liable under the policy for the amount of the claim.

In either case the person against whom the claim is asserted may attempt an accord and satisfaction of the disputed claim by tendering a check to the claimant for some amount less than the full amount claimed by the claimant. A statement will be included on the check or in a communication accompanying the check to the effect that the check is offered as full payment or full satisfaction of the claim. Frequently, there is also a statement to the effect that obtaining payment of the check is an agreement by the claimant to a settlement of the dispute for the amount tendered. Before enactment of revised Article 3, the case law was in conflict over the question of whether obtaining payment of the check had the effect of an agreement to the settlement proposed by the debtor. This issue was governed by a common law rule, but some courts hold that the common law was modified by former Section 1-207 which they interpreted as applying to full settlement checks.

2. Comment d. to Restatement of Contracts, Section 281 discusses the full satisfaction check and the applicable common law rule. In a case like Case #1, the buyer can propose a settlement of the disputed bill by a clear notation on the check indicating that the check is tendered as full satisfaction of the bill. Under the common law rule the seller, by obtaining payment of the check accepts the offer of compromise by the buyer. The result is the same if the seller adds a notation to the check indicating that the

check is accepted under protest or in only partial satisfaction of the claim. Under the common law rule the seller can refuse the check or can accept it subject to the condition stated by the buyer, but the seller can't accept the check and refuse to be bound by the condition. The rule applies only to an unliquidated claim or a claim disputed in good faith by the buyer. The dispute in the courts was whether Section 1-207 changed the common law rule. The Restatement states that section "need not be read as changing this well-established rule."

3. As part of the revision of Article 3, Section 1-207 has been amended to add subsection (2) stating that Section 1-207 "does not apply to an accord and satisfaction." Because of that amendment and revised Article 3, Section 3-311 governs full satisfaction checks. Section 3-311 follows the common law rule with some minor variations to reflect modern business conditions. In cases covered by Section 3-311 there will often be an individual on one side of the dispute and a business organization on the other. This section is not designed to favor either the individual or the business organization. In Case #1 the person seeking the accord and satisfaction is an individual. In Case #2 the person seeking the accord and satisfaction is an insurance company. Section 3-311 is based on a belief that the common law rule produces a fair result and that informal dispute resolution by full satisfaction checks should be encouraged.

4. Subsection (a) states three requirements for application of Section 3-311. "Good faith" in subsection (a)(i) is defined in Section 3-103(a)(4) as not only honesty in fact, but the observance of reasonable commercial standards of fair dealing. The meaning of "fair dealing" will depend upon the facts in the particular case. For example, suppose an insurer tenders a check in settlement of a claim for personal injury in an accident clearly covered by the insurance policy. The claimant is necessitous and the amount of the check is very small in relationship to the extent of the injury and the amount recoverable under the policy. If the trier of fact determines that the insurer was taking unfair advantage of the claimant, an accord and satisfaction would not result from payment of the check because of the absence of good faith by the insurer in making the tender. Another example of lack of good faith is found in the practice of some business debtors in routinely printing full satisfaction language on their check stocks so that all or a large part of the debts of the debtor are paid by checks bearing the full

satisfaction language, whether or not there is any dispute with the creditor. Under such a practice the claimant cannot be sure whether a tender in full satisfaction is or is not being made. Use of a check on which full satisfaction language was affixed routinely pursuant to such a business practice may prevent an accord and satisfaction on the ground that the check was not tendered in good faith under subsection (a)(i).

Section 3-311 does not apply to cases in which the debt is a liquidated amount and not subject to a bona fide dispute. Subsection (a)(ii). Other law applies to cases in which a debtor is seeking discharge of such a debt by paying less than the amount owed. For the purpose of subsection (a)(iii) obtaining acceptance of a check is considered to be obtaining payment of the check.

The person seeking the accord and satisfaction must prove that the requirements of subsection (a) are met. If that person also proves that the statement required by subsection (b) was given, the claim is discharged unless subsection (c) applies. Normally the statement required by subsection (b) is written on the check. Thus, the cancelled check can be used to prove the statement as well as the fact that the claimant obtained payment of the check. Subsection (b) requires a "conspicuous" statement that the instrument was tendered in full satisfaction of the claim. "Conspicuous" is defined in Section 1-201(10). The statement is conspicuous if "it is so written that a reasonable person against whom it is to operate ought to have noticed it." If the claimant can reasonably be expected to examine the check, almost any statement on the check should be noticed and is therefore conspicuous. In cases in which the claimant is an individual the claimant will receive the check and will normally indorse it. Since the statement concerning tender in full satisfaction normally will appear above the space provided for the claimant's indorsement of the check, the claimant "ought to have noticed" the statement.

5. Subsection (c)(1) is a limitation on subsection (b) in cases in which the claimant is an organization. It is designed to protect the claimant against inadvertent accord and satisfaction. If the claimant is an organization payment of the check might be obtained without notice to the personnel of the organization concerned with the disputed claim. Some business organizations have claims against very large numbers of customers. Examples are department stores, public utilities and the like. These claims

are normally paid by checks sent by customers to a designated office at which clerks employed by the claimant or a bank acting for the claimant process the checks and record the amounts paid. If the processing office is not designed to deal with communications extraneous to recording the amount of the check and the account number of the customer, payment of a full satisfaction check can easily be obtained without knowledge by the claimant of the existence of the full satisfaction statement. This is particularly true if the statement is written on the reverse side of the check in the area in which indorsements are usually written. Normally, the clerks of the claimant have no reason to look at the reverse side of checks. Indorsement by the claimant normally is done by mechanical means or there may be no indorsement at all. Section 4-205(a). Subsection (c)(1) allows the claimant to protect itself by advising customers by a conspicuous statement that communications regarding disputed debts must be sent to a particular person, office, or place. The statement must be given to the customer within a reasonable time before the tender is made. This requirement is designed to assure that the customer has reasonable notice that the full satisfaction check must be sent to a particular place. The reasonable time requirement could be satisfied by a notice on the billing statement sent to the customer. If the full satisfaction check is sent to the designated destination and the check is paid, the claim is discharged. If the claimant proves that the check was not received at the designated destination the claim is not discharged unless subsection (d) applies.

6. Subsection (c)(2) is also designed to prevent inadvertent accord and satisfaction. It can be used by a claimant other than an organization or by a claimant as an alternative to subsection (c)(1). Some organizations may be reluctant to use subsection (c)(1) because it may result in confusion of customers that causes checks to be routinely sent to the special designated person, office, or place. Thus, much of the benefit of rapid processing of checks may be lost. An organization that chooses not to send a notice complying with subsection (c)(1)(i) may prevent an inadvertent accord and satisfaction by complying with subsection (c)(2). If the claimant discovers that it has obtained payment of a full satisfaction check, it may prevent an accord and satisfaction if, within 90 days of the payment of the check, the claimant tenders repayment of the amount of the check to the person against whom the claim is asserted.

7. Subsection (c) is subject to subsection (d). If a person against whom a claim is asserted proves that the claimant obtained payment of a check known to have been tendered in full satisfaction of the claim by "the claimant or an agent of the claimant having direct responsibility with respect to the disputed obligation," the claim is discharged even if (i) the check was not sent to the person, office, or place required by a notice complying with subsection (c)(1), or (ii) the claimant tendered repayment of the amount of the check in compliance with subsection (c)(2).

A claimant knows that a check was tendered in full satisfaction of a claim when the claimant "has actual knowledge" of that fact. Section 1-201(25) [1-202]. Under Section 1-201(27) [1-202], if the claimant is an organization, it has knowledge that a check was tendered in full satisfaction of the claim when that fact is

> "brought to the attention of the individual conducting that transaction, and in any event when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information."

With respect to an attempted accord and satisfaction the "individual conducting that transaction" is an employee or other agent of the organization having direct responsibility with respect to the dispute. For example, if the check and communication are received by a collection agency acting for the claimant to collect the disputed claim, obtaining payment of the check will result in an accord and satisfaction even if the claimant gave notice, pursuant to subsection (c)(1), that full satisfaction checks be sent to some other office. Similarly, if a customer asserting a claim for breach of warranty with respect to defective goods purchased in a retail outlet of a large chain store delivers the full satisfaction check to the manager of the retail outlet at which the goods were purchased, obtaining payment of the check will also result in an accord and satisfaction. On the other hand, if the check is mailed to the chief executive officer of the chain

store subsection (d) would probably not be satisfied. The chief executive officer of a large corporation may have general responsibility for operations of the company, but does not normally have direct responsibility for resolving a small disputed bill to a customer. A check for a relatively small amount mailed to a high executive officer of a large organization is not likely to receive the executive's personal attention. Rather, the check would normally be routinely sent to the appropriate office for deposit and credit to the customer's account. If the check does receive the personal attention of the high executive officer and the officer is aware of the full-satisfaction language, collection of the check will result in an accord and satisfaction because subsection (d) applies. In this case the officer has assumed direct responsibility with respect to the disputed transaction.

If a full satisfaction check is sent to a lock box or other office processing checks sent to the claimant, it is irrelevant whether the clerk processing the check did or did not see the statement that the check was tendered as full satisfaction of the claim. Knowledge of the clerk is not imputed to the organization because the clerk has no responsibility with respect to an accord and satisfaction. Moreover, there is no failure of "due diligence" under Section 1-201(27) [1-202] if the claimant does not require its clerks to look for full satisfaction statements on checks or accompanying communications. Nor is there any duty of the claimant to assign that duty to its clerks. Section 3-311(c) is intended to allow a claimant to avoid an inadvertent accord and satisfaction by complying with either subsection (c)(1) or (2) without burdening the check-processing operation with extraneous and wasteful additional duties.

8. In some cases the disputed claim may have been assigned to a finance company or bank as part of a financing arrangement with respect to accounts receivable. If the account debtor was notified of the assignment, the claimant is the assignee of the account receivable and the "agent of the claimant" in subsection (d) refers to an agent of the assignee.

§ 28-3-311. Lost, destroyed, or stolen cashier's check, teller's check or certified check. — (1) In this section:

(a) "Check" means a cashier's check, teller's check or certified check.

(b) "Claimant" means a person who claims the right to receive the amount of a cashier's check, teller's check, or certified check that was lost, destroyed or stolen.

(c) "Declaration of loss" means a written statement, made under penalty of perjury, to the effect that (i) the declarer lost possession of a check, (ii) the declarer is the drawer or payee of the check, in the case of a certified check, or the remitter or payee of the check, in the case of a cashier's check or teller's check, (iii) the loss of possession was not the result of a transfer by the declarer or a lawful seizure, and (iv) the declarer cannot reasonably obtain possession of the check because the check was destroyed, its whereabouts cannot be determined, or it is in the wrongful possession of an unknown person or a person that cannot be found or is not amenable to service of process.

(d) "Obligated bank" means the issuer of a cashier's check or teller's check or the acceptor of a certified check.

(2) A claimant may assert a claim to the amount of a check by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check, if (i) the claimant is the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check, (ii) the communication contains or is accompanied by a declaration of loss of the claimant with respect to the check, (iii) the communication is received at a time and in a manner affording the bank a reasonable time to act on it before the check is paid, and (iv) the claimant provides reasonable identification if requested by the obligated bank. Delivery of a declaration of loss is a warranty of the truth of the statements made in the declaration. If a claim is asserted in compliance with this subsection, the following rules apply:

(a) The claim becomes enforceable at the later of (i) the time the claim is asserted, or (ii) the 90th day following the date of the check, in the case

of a cashier's check or teller's check, or the 90th day following the date of the acceptance, in the case of a certified check.

(b) Until the claim becomes enforceable, it has no legal effect and the obligated bank may pay the check or, in the case of a teller's check, may permit the drawee to pay the check. Payment to a person entitled to enforce the check discharges all liability of the obligated bank with respect to the check.

(c) If the claim becomes enforceable before the check is presented for payment, the obligated bank is not obliged to pay the check.

(d) When the claim becomes enforceable, the obligated bank becomes obliged to pay the amount of the check to the claimant if payment of the check has not been made to a person entitled to enforce the check. Subject to section 28-4-302(1)(a)[, Idaho Code], payment to the claimant discharges all liability of the obligated bank with respect to the check.

(3) If the obligated bank pays the amount of a check to a claimant under subsection (2)(d) of this section and the check is presented for payment by a person having rights of a holder in due course, the claimant is obliged to (i) refund the payment to the obligated bank if the check is paid, or (ii) pay the amount of the check to the person having rights of a holder in due course if the check is dishonored.

(4) If a claimant has the right to assert a claim under subsection (2) of this section and is also a person entitled to enforce a cashier's check, teller's check or certified check which is lost, destroyed or stolen, the claimant may assert rights with respect to the check either under this section or section 28-3-309[, Idaho Code].

History.

I.C., § 28-3-311, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Compiler's Notes.

Since the Idaho legislature in enacting Uniform Commercial Code — Negotiable Instruments (S.L. 1993, ch. 288) did not adopt § 3-307 of the uniform version, §§ 28-3-307 to 28-3-111 of the Idaho Code correspond to

§§ 3-308 to 3-312 of the uniform version. Thus, references to Section 3-312 in the Official Comment, below, are actually to this section.

The bracketed insertions in paragraph (2)(d) and at the end of subsection (4) were added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

ALR. — Rights of one who acquires lost or stolen traveler's checks. 42 A.L.R.3d 846.

Official Comment

1. This section applies to cases in which a cashier's check, teller's check, or certified check is lost, destroyed, or stolen. In one typical case a customer of a bank closes his or her account and takes a cashier's check or teller's check of the bank as payment of the amount of the account. The customer may be moving to a new area and the check is to be used to open a bank account in that area. In such a case the check will normally be payable to the customer. In another typical case a cashier's check or teller's check is bought from a bank for the purpose of paying some obligation of the buyer of the check. In such a case the check may be made payable to the customer and then negotiated to the creditor by indorsement. But often, the payee of the check is the creditor. In the latter case the customer is a remitter. The section covers loss of the check by either the remitter or the payee. The section also covers loss of a certified check by either the drawer or payee.

Under Section 3-309 a person seeking to enforce a lost, destroyed, or stolen cashier's check or teller's check may be required by the court to give adequate protection to the issuing bank against loss that might occur by reason of the claim by another person to enforce the check. This might require the posting of an expensive bond for the amount of the check. Moreover, Section 3-309 applies only to a person entitled to enforce the check. It does not apply to a remitter of a cashier's check or teller's check or to the drawer of a certified check. Section 3-312 applies to both. The purpose of Section 3-312 is to offer a person who loses such a check a means of getting refund of the amount of the check within a reasonable period of time without the expense of posting a bond and with full protection of the obligated bank.

2. A claim to the amount of a lost, destroyed, or stolen cashier's check, teller's check, or certified check may be made under subsection (b) if the following requirements of that subsection are met. First, a claim may be asserted only by the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check. An indorsee of a check is not covered because the indorsee is not an original party to the check or a remitter. Limitation to an original party or remitter gives the obligated bank the ability to determine, at the time it becomes obligated on the check, the identity of the person or persons who can assert a claim with respect to the check. The bank is not faced with having to determine the rights of some person who was not a party to the check at that time or with whom the bank had not dealt. If a cashier's check is issued to the order of the person who purchased it from the bank and that person indorses it over to a third person who loses the check, the third person may assert rights to enforce the check under Section 3-309 but has no rights under Section 3-312.

Second, the claim must be asserted by a communication to the obligated bank describing the check with reasonable certainty and requesting payment of the amount of the check. "Obligated bank" is defined in subsection (a)(4). Third, the communication must be received in time to allow the obligated bank to act on the claim before the check is paid, and the claimant must provide reasonable identification if requested. Subsections (b)(iii) and (iv). Fourth, the communication must contain or be accompanied by a declaration of loss described in subsection (b). This declaration is an affidavit or other writing made under penalty of perjury alleging the loss, destruction, or theft of the check and stating that the declarer is a person entitled to assert a claim, *i.e.* the drawer or payee of a certified check or the remitter or payee of a cashier's check or teller's check.

A claimant who delivers a declaration of loss makes a warranty of the truth of the statements made in the declaration. The warranty is made to the obligated bank and anybody who has a right to enforce the check. If the declaration of loss falsely alleges loss of a cashier's check that did not in fact occur, a holder of the check who was unable to obtain payment because subsection (b)(3) and (4) caused the obligated bank to dishonor the check would have a cause of action against the declarer for breach of warranty.

The obligated bank may not impose additional requirements on the claimant to assert a claim under subsection (b). For example, the obligated

bank may not require the posting of a bond or other form of security. Section 3-312(b) states the procedure for asserting claims covered by the section. Thus, procedures that may be stated in other law for stating claims to property do not apply and are displaced within the meaning of Section 1-103.

3. A claim asserted under subsection (b) does not have any legal effect, however, until the date it becomes enforceable, which cannot be earlier than 90 days after the date of a cashier's check or teller's check or 90 days after the date of acceptance of a certified check. Thus, if a lost check is presented for payment within the 90-day period, the bank may pay a person entitled to enforce the check without regard to the claim and is discharged of all liability with respect to the check. This ensures the continued utility of cashier's checks, teller's checks, and certified checks as cash equivalents. Virtually all such checks are presented for payment within 90 days.

If the claim becomes enforceable and payment has not been made to a person entitled to enforce the check, the bank becomes obligated to pay the amount of the check to the claimant. Subsection (b)(4). When the bank becomes obligated to pay the amount of the check to the claimant, the bank is relieved of its obligation to pay the check. Subsection (b)(3). Thus, any person entitled to enforce the check, including even a holder in due course, loses the right to enforce the check after a claim under subsection (b) becomes enforceable.

If the obligated bank pays the claimant under subsection (b)(4), the bank is discharged of all liability with respect to the check. The only exception is the unlikely case in which the obligated bank subsequently incurs liability under Section 4-302 (a)(1) with respect to the check. For example, Obligated Bank is the issuer of a cashier's check and, after a claim becomes enforceable, it pays the claimant under subsection (b)(4). Later the check is presented to Obligated Bank for payment over the counter. Under subsection (b)(3), Obligated Bank is not obliged to pay the check and may dishonor the check by returning it to the person who presented it for payment. But the normal rules of check collection are not affected by Section 3-312. If Obligated Bank retains the check beyond midnight of the day of presentment without settling for it, it becomes accountable for the amount of the check under Section 4-302(a)(1) even though it had no obligation to pay the check.

An obligated bank that pays the amount of a check to a claimant under subsection (b)(4) is discharged of all liability on the check so long as the assertion of the claim meets the requirements of subsection (b) discussed in Comment 2. This is important in cases of fraudulent declarations of loss. For example, if the claimant falsely alleges a loss that in fact did not occur, the bank, subject to Section 1-203, may rely on the declaration of loss. On the other hand, a claim may be asserted only by a person described in subsection (b)(i). Thus, the bank is discharged under subsection (a)(4) only if it pays such a person. Although it is highly unlikely, it is possible that more than one person could assert a claim under subsection (b) to the amount of a check. Such a case could occur if one of the claimants makes a false declaration of loss. The obligated bank is not required to determine whether a claimant who complies with subsection (b) is acting wrongfully. The bank may utilize procedures outside this Article, such as interpleader, under which the conflicting claims may be adjudicated.

Although it is unlikely that a lost check would be presented for payment after the claimant was paid by the bank under subsection (b)(4), it is possible for it to happen. Suppose the declaration of loss by the claimant fraudulently alleged a loss that in fact did not occur. If the claimant negotiated the check, presentment for payment would occur shortly after negotiation in almost all cases. Thus, a fraudulent declaration of loss is not likely to occur unless the check is negotiated after the 90-day period has already expired or shortly before expiration. In such a case the holder of the check, who may not have noticed the date of the check, is not entitled to payment from the obligated bank if the check is presented for payment after the claim becomes enforceable. Subsection (b)(3). The remedy of the holder who is denied payment in that case is an action against the claimant under subsection (c) if the holder is a holder in due course, or for breach of warranty under subsection (b). The holder would also have common law remedies against the claimant under the law of restitution or fraud.

4. The following cases illustrate the operation of Section 3-312:

Case #1. Obligated Bank (OB) certified a check drawn by its customer, Drawer (D), payable to Payee (P). Two days after the check was certified, D lost the check and then asserted a claim pursuant to subsection (b). The check had not been presented for payment when D's claim became enforceable 90 days after the check was certified. Under

subsection (b)(4), at the time D's claim became enforceable OB became obliged to pay D the amount of the check. If the check is later presented for payment, OB may refuse to pay the check and has no obligation to anyone to pay the check. Any obligation owed by D to P, for which the check was intended as payment, is unaffected because the check was never delivered to P.

Case #2. Obligated Bank (OB) issued a teller's check to Remitter (R) payable to Payee (P). R delivered the check to P in payment of an obligation. P lost the check and then asserted a claim pursuant to subsection (b). To carry out P's order, OB issued an order pursuant to Section 4-403(a) to the drawee of the teller's check to stop payment of the check effective on the 90th day after the date of the teller's check. The check was not presented for payment. On the 90th day after the date of the teller's check P's claim becomes enforceable and OB becomes obliged to pay P the amount of the check. As in Case #1, OB has no further liability with respect to the check to anyone. When R delivered the check to P, R's underlying obligation to P was discharged under Section 3-310. Thus, R suffered no loss. Since P received the amount of the check, P also suffered no loss except with respect to the delay in receiving the amount of the check.

Case #3. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). Two days after issue, the check was stolen from P who then asserted a claim pursuant to subsection (b). Ten days after issue, the check was deposited by X in an account in Depositary Bank (DB). X had found the check and forged the indorsement of P. DB promptly presented the check to OB and obtained payment on behalf of X. On the 90th day after the date of the check P's claim becomes enforceable and P is entitled to receive the amount of the check from OB. Subsection (b)(4). Although the check was presented for payment before P's claim becomes enforceable, OB is not discharged. Because of the forged indorsement X was not a holder and neither was DB. Thus, neither is a person entitled to enforce the check (Section 3-301) and OB is not discharged under Section 3-602(a). Thus, under subsection (b)(4), because OB did not pay a person entitled to enforce the check, OB must pay P. OB's remedy is against DB for breach of warranty under Section

4-208(a)(1). As an alternative to the remedy under Section 3-312, P could recover from DB for conversion under Section 3-420(a).

Case #4. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). P made an unrestricted blank indorsement of the check and mailed the check to P's bank for deposit to P's account. The check was never received by P's bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). X found the check and deposited it in X's account in Depositary Bank (DB) after indorsing the check. DB presented the check for payment before the end of the 90-day period after its date. OB paid the check. Because of the unrestricted blank indorsement by P, X became a holder of the check. DB also became a holder. Since the check was paid before P's claim became enforceable and payment was made to a person entitled to enforce the check, OB is discharged of all liability with respect to the check. Subsection (b)(2). Thus, P is not entitled to payment from OB. Subsection (b)(4) doesn't apply.

Case #5. Obligated Bank (OB) issued a cashier's check to its customer, Payee (P). P made an unrestricted blank indorsement of the check and mailed the check to P's bank for deposit to P's account. The check was never received by P's bank. When P discovered the loss, P asserted a claim pursuant to subsection (b). At the end of the 90-day period after the date of the check, OB paid the amount of the check to P under subsection (b)(4). X then found the check and deposited it to X's account in Depositary Bank (DB). DB presented the check to OB for payment. OB is not obliged to pay the check. Subsection (b)(4). If OB dishonors the check, DB's remedy is to charge back X's account. Section 4-214(a). Although P, as an indorser, would normally have liability to DB under Section 3-415(a) because the check was dishonored, P is released from that liability under Section 3-415(e) because collection of the check was initiated more than 30 days after the indorsement. DB has a remedy only against X. A depositary bank that takes a cashier's check that cannot be presented for payment before expiration of the 90-day period after its date is on notice that the check might not be paid because of the possibility of a claim asserted under subsection (b) which would excuse the issuer of the check from paying the check. Thus, the depositary bank cannot safely release funds with respect to the check until it has

assurance that the check has been paid. DB cannot be a holder in due course of the check because it took the check when the check was overdue. Section 3-304(a)(2). Thus, DB has no action against P under subsection (c).

Case #6. Obligated Bank (OB) issued a cashier's check payable to bearer and delivered it to its customer, Remitter (R). R held the check for 90 days and then wrongfully asserted a claim to the amount of the check under subsection (b). The declaration of loss fraudulently stated that the check was lost. R received payment from OB under subsection (b)(4). R then negotiated the check to X for value. X presented the check to OB for payment. Although OB, under subsection (b)(2), was not obliged to pay the check, OB paid X by mistake. OB's teller did not notice that the check was more than 90 days old and was not aware that OB was not obliged to pay the check. If X took the check in good faith, OB may not recover from X. Section 3-418 (c). OB's remedy is to recover from R for fraud or for breach of warranty in making a false declaration of loss. Subsection (b).

Part 4
Liability of Parties

• Title 28 •, « Ch. 3 », « Pt. 4 », • § 28-3-401 »

Idaho Code § 28-3-401

§ 28-3-401. Signature. — (1) A person is not liable on an instrument unless (i) the person signed the instrument, or (ii) the person is represented by an agent or representative who signed the instrument and the signature is binding on the represented person under section 28-3-402[, Idaho Code].

(2) A signature may be made (i) manually or by means of a device or machine, and (ii) by the use of any name, including a trade or assumed name, or by a word, mark or symbol executed or adopted by a person with present intention to authenticate a writing.

History.

I.C., § 28-3-401, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-401 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion at the end of subsection (1) was added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law Signature As Accommodation to Corporation.

Mortgagor could not make use of the impairment of collateral defense where mortgagor was the only party who signed promissory notes as obligor, notwithstanding his claim that he signed the notes as an accommodation to his corporation; no other party signed the notes as an obligor and the name of the corporation did not appear on the face of the

notes. First Nat'l Bank v. Burgess, 118 Idaho 627, 798 P.2d 472 (Ct. App. 1990).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 42 et seq.

68A Am. Jur. 2d, Secured Transactions, § 345 et seq.

C.J.S. — 10 C.J.S., Bills and Notes, § 30 et seq.

Official Comment

1. Obligation on an instrument depends on a signature that is binding on the obligor. The signature may be made by the obligor personally or by an agent authorized to act for the obligor. Signature by agents is covered by Section 3-402. It is not necessary that the name of the obligor appear on the instrument, so long as there is a signature that binds the obligor. Signature includes an indorsement.

2. A signature may be handwritten, typed, printed or made in any other manner. It need not be subscribed, and may appear in the body of the instrument, as in the case of "I, John Doe, promise to pay *" without any other signature. It may be made by mark, or even by thumbprint. It may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for the purpose. Parol evidence is admissible to identify the signer, and when the signer is identified the signature is effective. Indorsement in a name other than that of the indorser is governed by Section 3-204(d).

This section is not intended to affect any other law requiring a signature by mark to be witnessed, or any signature to be otherwise authenticated, or requiring any form of proof.

§ 28-3-402. Signature by representative. — (1) If a person acting, or purporting to act, as a representative signs an instrument by signing either the name of the represented person or the name of the signer, the represented person is bound by the signature to the same extent the represented person would be bound if the signature were on a simple contract. If the represented person is bound, the signature of the representative is the "authorized signature of the represented person" and the represented person is liable on the instrument, whether or not identified in the instrument.

(2) If a representative signs the name of the representative to an instrument and the signature is an authorized signature of the represented person, the following rules apply:

(a) If the form of the signature shows unambiguously that the signature is made on behalf of the represented person who is identified in the instrument, the representative is not liable on the instrument.

(b) Subject to subsection (3) of this section, if (i) the form of the signature does not show unambiguously that the signature is made in a representative capacity, or (ii) the represented person is not identified in the instrument, the representative is liable on the instrument to a holder in due course that took the instrument without notice that the representative was not intended to be liable on the instrument. With respect to any other person, the representative is liable on the instrument unless the representative proves that the original parties did not intend the representative to be liable on the instrument.

(3) If a representative signs the name of the representative as drawer of a check without indication of the representative status and the check is payable from an account of the represented person who is identified on the check, the signer is not liable on the check if the signature is an authorized signature of the represented person.

History.

I.C., § 28-3-402, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-402 was repealed. See Prior Laws, § 28-3-101.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 42.

ALR. — Authorized representative signing negotiable instrument in his own name. 97 A.L.R.3d 798.

Official Comment

1. Subsection (a) states when the represented person is bound on an instrument if the instrument is signed by a representative. If under the law of agency the represented person would be bound by the act of the representative in signing either the name of the represented person or that of the representative, the signature is the authorized signature of the represented person. Former Section 3-401(1) stated that "no person is liable on an instrument unless his signature appears thereon." This was interpreted as meaning that an undisclosed principal is not liable on an instrument. This interpretation provided an exception to ordinary agency law that binds an undisclosed principal on a simple contract.

It is questionable whether this exception was justified by the language of former Article 3 and there is no apparent policy justification for it. The exception is rejected by subsection (a) which returns to ordinary rules of agency. If P, the principal, authorized A, the agent, to borrow money on P's behalf and A signed A's name to a note without disclosing that the signature was on behalf of P, A is liable on the instrument. But if the person entitled to enforce the note can also prove that P authorized A to sign on P's behalf, why shouldn't P also be liable on the instrument? To recognize the liability of P takes nothing away from the utility of negotiable instruments. Furthermore, imposing liability on P has the merit of making it impossible to have an instrument on which nobody is liable even though it was authorized by P. That result could occur under former 3-401(1) if an authorized agent signed "as agent" but the note did not identify the

principal. If the dispute was between the agent and the payee of the note, the agent could escape liability on the note by proving that the agent and the payee did not intend that the agent be liable on the note when the note was issued. Former Section 3-403(2)(b). Under the prevailing interpretation of former Section 3-401(1), the principal was not liable on the note under former 3-401(1) because the principal's name did not appear on the note. Thus, nobody was liable on the note even though all parties knew that the note was signed by the agent on behalf of the principal. Under Section 3-402(a) the principal would be liable on the note.

2. Subsection (b) concerns the question of when an agent who signs an instrument on behalf of a principal is bound on the instrument. The approach followed by former Section 3-403 was to specify the form of signature that imposed or avoided liability. This approach was unsatisfactory. There are many ways in which there can be ambiguity about a signature. It is better to state a general rule. Subsection (b)(1) states that if the form of the signature unambiguously shows that it is made on behalf of an identified represented person (for example, "P, by A, Treasurer") the agent is not liable. This is a workable standard for a court to apply. Subsection (b)(2) partly changes former Section 3-403(2). Subsection (b)(2) relates to cases in which the agent signs on behalf of a principal but the form of the signature does not fall within subsection (b)(1). The following cases are illustrative. In each case John Doe is the authorized agent of Richard Roe and John Doe signs a note on behalf of Richard Roe. In each case the intention of the original parties to the instrument is that Roe is to be liable on the instrument but Doe is not to be liable.

Case #1. Doe signs "John Doe" without indicating in the note that Doe is signing as agent. The note does not identify Richard Roe as the represented person.

Case #2. Doe signs "John Doe, Agent" but the note does not identify Richard Roe as the represented person.

Case #3. The name "Richard Roe" is written on the note and immediately below that name Doe signs "John Doe" without indicating that Doe signed as agent.

In each case Doe is liable on the instrument to a holder in due course without notice that Doe was not intended to be liable. In none of the cases

does Doe's signature unambiguously show that Doe was signing as agent for an identified principal. A holder in due course should be able to resolve any ambiguity against Doe.

But the situation is different if a holder in due course is not involved. In each case Roe is liable on the note. Subsection (a). If the original parties to the note did not intend that Doe also be liable, imposing liability on Doe is a windfall to the person enforcing the note. Under subsection (b)(2) Doe is prima facie liable because his signature appears on the note and the form of the signature does not unambiguously refute personal liability. But Doe can escape liability by proving that the original parties did not intend that he be liable on the note. This is a change from former Section 3-403(2)(a).

A number of cases under former Article 3 involved situations in which an agent signed the agent's name to a note, without qualification and without naming the person represented, intending to bind the principal but not the agent. The agent attempted to prove that the other party had the same intention. Some of these cases involved mistake, and in some there was evidence that the agent may have been deceived into signing in that manner. In some of the cases the court refused to allow proof of the intention of the parties and imposed liability on the agent based on former Section 3-403(2)(a) even though both parties to the instrument may have intended that the agent not be liable. Subsection (b)(2) changes the result of those cases, and is consistent with Section 3-117 which allows oral or written agreements to modify or nullify apparent obligations on the instrument.

Former Section 3-403 spoke of the represented person being "named" in the instrument. Section 3-402 speaks of the represented person being "identified" in the instrument. This change in terminology is intended to reject decisions under former Section 3-403(2) requiring that the instrument state the legal name of the represented person.

3. Subsection (c) is directed at the check cases. It states that if the check identifies the represented person the agent who signs on the signature line does not have to indicate agency status. Virtually all checks used today are in personalized form which identify the person on whose account the check is drawn. In this case, nobody is deceived into thinking that the person signing the check is meant to be liable. This subsection is meant to overrule

cases decided under former Article 3 such as *Griffin v. Ellinger,* 538 S.W.2d 97 (Texas 1976).

§ 28-3-403. Unauthorized signature. — (1) Unless otherwise provided in this chapter or chapter 4[, title 28, Idaho Code], an unauthorized signature is ineffective except as the signature of the unauthorized signer in favor of a person who in good faith pays the instrument or takes it for value. An unauthorized signature may be ratified for all purposes of this chapter.

(2) If the signature of more than one (1) person is required to constitute the authorized signature of an organization, the signature of the organization is unauthorized if one (1) of the required signatures is lacking.

(3) The civil or criminal liability of a person who makes an unauthorized signature is not affected by any provision of this chapter which makes the unauthorized signature effective for the purposes of this chapter.

History.

I.C., § 28-3-403, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-4-403 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in subsection (1) was added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Unauthorized Agent.

Where unauthorized agent of Colorado company wrongfully obtained funds via check to said company from purchasers in return for merchandise which alleged agent indicated he had authority to sell, and where alleged agent did not impersonate anyone, but merely represented that he was the

authorized agent of Colorado company, purchasers were entitled to have the authorized indorsement of Colorado company before the check was charged against their account, and bank upon which check was drawn was not entitled to charge the purchasers' account for the check that alleged agent indorsed as agent of said company where indorsement was not authorized. Valley Bank v. Monarch Inv. Co., 118 Idaho 747, 800 P.2d 634 (1990).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 539 et seq.

ALR. — What constitutes ratification of unauthorized signature under UCC § 3-404. 93 A.L.R.3d 967.

Official Comment

1. "Unauthorized" signature is defined in Section 1-201(43) as one that includes a forgery as well as a signature made by one exceeding actual or apparent authority. Former Section 3-404(1) stated that an unauthorized signature was inoperative as the signature of the person whose name was signed unless that person "is precluded from denying it." Under former Section 3-406 if negligence by the person whose name was signed contributed to an unauthorized signature, that person "is precluded from asserting the * lack of authority." Both of these sections were applied to cases in which a forged signature appeared on an instrument and the person asserting rights on the instrument alleged that the negligence of the purported signer contributed to the forgery. Since the standards for liability between the two sections differ, the overlap between the sections caused confusion. Section 3-403(a) deals with the problem by removing the preclusion language that appeared in former Section 3-404.

2. The except clause of the first sentence of subsection (a) states the generally accepted rule that the unauthorized signature, while it is wholly inoperative as that of the person whose name is signed, is effective to impose liability upon the signer or to transfer any rights that the signer may have in the instrument. The signer's liability is not in damages for breach of warranty of authority, but is full liability on the instrument in the capacity in which the signer signed. It is, however, limited to parties who take or pay

the instrument in good faith; and one who knows that the signature is unauthorized cannot recover from the signer on the instrument.

3. The last sentence of subsection (a) allows an unauthorized signature to be ratified. Ratification is a retroactive adoption of the unauthorized signature by the person whose name is signed and may be found from conduct as well as from express statements. For example, it may be found from the retention of benefits received in the transaction with knowledge of the unauthorized signature. Although the forger is not an agent, ratification is governed by the rules and principles applicable to ratification of unauthorized acts of an agent.

Ratification is effective for all purposes of this Article. The unauthorized signature becomes valid so far as its effect as a signature is concerned. Although the ratification may relieve the signer of liability on the instrument, it does not of itself relieve the signer of liability to the person whose name is signed. It does not in any way affect the criminal law. No policy of the criminal law prevents a person whose name is forged to assume liability to others on the instrument by ratifying the forgery, but the ratification cannot affect the rights of the state. While the ratification may be taken into account with other relevant facts in determining punishment, it does not relieve the signer of criminal liability.

4. Subsection (b) clarifies the meaning of "unauthorized" in cases in which an instrument contains less than all of the signatures that are required as authority to pay a check. Judicial authority was split on the issue whether the one-year notice period under former Section 4-406(4) (now Section 4-406(f)) barred a customer's suit against a payor bank that paid a check containing less than all of the signatures required by the customer to authorize payment of the check. Some cases took the view that if a customer required that a check contain the signatures of both A and B to authorize payment and only A signed, there was no unauthorized signature within the meaning of that term in former Section 4-406(4) because A's signature was neither unauthorized nor forged. The other cases correctly pointed out that it was the customer's signature at issue and not that of A; hence, the customer's signature was unauthorized if all signatures required to authorize payment of the check were not on the check. Subsection (b) follows the latter line of cases. The same analysis applies if A forged the

signature of B. Because the forgery is not effective as a signature of B, the required signature of B is lacking.

Subsection (b) refers to "the authorized signature of an organization." The definition of "organization" in Section 1-201(28) [1-201(25)]is very broad. It covers not only commercial entities but also "two or more persons having a joint or common interest." Hence subsection (b) would apply when a husband and wife are both required to sign an instrument.

§ 28-3-404. Impostors — Fictitious payees. — (1) If an impostor, by use of the mails or otherwise, induces the issuer of an instrument to issue the instrument to the impostor, or to a person acting in concert with the impostor, by impersonating the payee of the instrument or a person authorized to act for the payee, an indorsement of the instrument by any person in the name of the payee is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(2) If (i) a person whose intent determines to whom an instrument is payable (section 28-3-110(1) or (2)[, Idaho Code]) does not intend the person identified as payee to have any interest in the instrument, or (ii) the person identified as payee of an instrument is a fictitious person, the following rules apply until the instrument is negotiated by special indorsement:

(a) Any person in possession of the instrument is its holder.

(b) An indorsement by any person in the name of the payee stated in the instrument is effective as the indorsement of the payee in favor of a person who, in good faith, pays the instrument or takes it for value or for collection.

(3) Under subsection (1) or (2) of this section, an indorsement is made in the name of a payee if (i) it is made in a name substantially similar to that of the payee, or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to that of the payee.

(4) With respect to an instrument to which subsection (1) or (2) of this section applies, if a person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from payment of the instrument, the person bearing the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

History.

I.C., § 28-3-404, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-404 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in the introductory paragraph in subsection (2) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

RESEARCH REFERENCES

ALR. — Construction and application of UCC § 3-405(1)(a) involving issuance of negotiable instrument induced by impostor. 92 A.L.R.3d 608.

Official Comment

1. Under former Article 3, the impostor cases were governed by former Section 3-405(1)(a) and the fictitious payee cases were governed by Section 3-405(1)(b). Section 3-404 replaces former Section 3-405(1)(a) and (b) and modifies the previous law in some respects. Former Section 3-405 was read by some courts to require that the indorsement be in the exact name of the named payee. Revised Article 3 rejects this result. Section 3-404(c) requires only that the indorsement be made in a name "substantially similar" to that of the payee. Subsection (c) also recognizes the fact that checks may be deposited without indorsement. Section 4-205(a).

Subsection (a) changes the former law in a case in which the impostor is impersonating an agent. Under former Section 3-405(1)(a), if Impostor impersonated Smith and induced the drawer to draw a check to the order of Smith, Impostor could negotiate the check. If Impostor impersonated Smith, the president of Smith Corporation, and the check was payable to the order of Smith Corporation, the section did not apply. See the last paragraph of Comment 2 to former Section 3-405. In revised Article 3, Section 3-404(a) gives Impostor the power to negotiate the check in both cases.

2. Subsection (b) is based in part on former Section 3-405(1)(b) and in part on N.I.L. § 9(3). It covers cases in which an instrument is payable to a fictitious or nonexisting person and to cases in which the payee is a real person but the drawer or maker does not intend the payee to have any interest in the instrument. Subsection (b) applies to any instrument, but its primary importance is with respect to checks of corporations and other organizations. It also applies to forged check cases. The following cases illustrate subsection (b):

Case #1. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer fraudulently draws a check of Corporation payable to Supplier Co., a nonexistent company. Subsection (b) applies because Supplier Co. is a fictitious person and because Treasurer did not intend Supplier Co. to have any interest in the check. Under subsection (b)(1) Treasurer, as the person in possession of the check, becomes the holder of the check. Treasurer indorses the check in the name "Supplier Co." and deposits it in Depositary Bank. Under subsection (b)(2) and (c)(i), the indorsement is effective to make Depositary Bank the holder and therefore a person entitled to enforce the instrument. Section 3-301.

Case #2. Same facts as Case #1 except that Supplier Co. is an actual company that does business with Corporation. If Treasurer intended to steal the check when the check was drawn, the result in Case #2 is the same as the result in Case #1. Subsection (b) applies because Treasurer did not intend Supplier Co. to have any interest in the check. It does not make any difference whether Supplier Co. was or was not a creditor of Corporation when the check was drawn. If Treasurer did not decide to steal the check until after the check was drawn, the case is covered by Section 3-405 rather than Section 3-404(b), but the result is the same. See Case #6 in Comment 3 to Section 3-405.

Case #3. Checks of Corporation must be signed by two officers. President and Treasurer both sign a check of Corporation payable to Supplier Co., a company that does business with Corporation from time to time but to which Corporation does not owe any money. Treasurer knows that no money is owed to Supplier Co. and does not intend that Supplier Co. have any interest in the check. President believes that money is owed to Supplier Co. Treasurer obtains possession of the check after it is signed. Subsection (b) applies because Treasurer is "a person

whose intent determines to whom an instrument is payable" and Treasurer does not intend Supplier Co. to have any interest in the check. Treasurer becomes the holder of the check and may negotiate it by indorsing it in the name "Supplier Co."

Case #4. Checks of Corporation are signed by a check-writing machine. Names of payees of checks produced by the machine are determined by information entered into the computer that operates the machine. Thief, a person who is not an employee or other agent of Corporation, obtains access to the computer and causes the check-writing machine to produce a check payable to Supplier Co., a nonexistent company. Subsection (b)(ii) applies. Thief then obtains possession of the check. At that point Thief becomes the holder of the check because Thief is the person in possession of the instrument. Subsection (b)(1). Under Section 3-301 Thief, as holder, is the "person entitled to enforce the instrument" even though Thief does not have title to the check and is in wrongful possession of it. Thief indorses the check in the name "Supplier Co." and deposits it in an account in Depositary Bank which Thief opened in the name "Supplier Co." Depositary Bank takes the check in good faith and credits the "Supplier Co." account. Under subsection (b)(2) and (c)(i), the indorsement is effective. Depositary Bank becomes the holder and the person entitled to enforce the check. The check is presented to the drawee bank for payment and payment is made. Thief then withdraws the credit to the account. Although the check was issued without authority given by Corporation, the drawee bank is entitled to pay the check and charge Corporation's account if there was an agreement with Corporation allowing the bank to debit Corporation's account for payment of checks produced by the check-writing machine whether or not authorized. The indorsement is also effective if Supplier Co. is a real person. In that case subsection (b)(i) applies. Under Section 3-110(b) Thief is the person whose intent determines to whom the check is payable, and Thief did not intend Supplier Co. to have any interest in the check. When the drawee bank pays the check, there is no breach of warranty under Section 3-417(a)(1) or 4-208(a)(1) because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment.

Case #5. Thief, who is not an employee or agent of Corporation, steals check forms of Corporation. John Doe is president of Corporation and is authorized to sign checks on behalf of Corporation as drawer. Thief draws a check in the name of Corporation as drawer by forging the signature of Doe. Thief makes the check payable to the order of Supplier Co. with the intention of stealing it. Whether Supplier Co. is a fictitious person or a real person, Thief becomes the holder of the check and the person entitled to enforce it. The analysis is the same as that in Case #4. Thief deposits the check in an account in Depositary Bank which Thief opened in the name "Supplier Co." Thief either indorses the check in a name other than "Supplier Co." or does not indorse the check at all. Under Section 4-205(a) a depositary bank may become holder of a check deposited to the account of a customer if the customer was a holder, whether or not the customer indorses. Subsection (c)(ii) treats deposit to an account in a name substantially similar to that of the payee as the equivalent of indorsement in the name of the payee. Thus, the deposit is an effective indorsement of the check. Depositary Bank becomes the holder of the check and the person entitled to enforce the check. If the check is paid by the drawee bank, there is no breach of warranty under Section 3-417(a)(1) or 4-208(a)(1) because Depositary Bank was a person entitled to enforce the check when it was forwarded for payment and, unless Depositary Bank knew about the forgery of Doe's signature, there is no breach of warranty under Section 3-417(a)(3) or 4-208(a)(3). Because the check was a forged check the drawee bank is not entitled to charge Corporation's account unless Section 3-406 or Section 4-406 applies.

3. In cases governed by subsection (a) the dispute will normally be between the drawer of the check that was obtained by the impostor and the drawee bank that paid it. The drawer is precluded from obtaining recredit of the drawer's account by arguing that the check was paid on a forged indorsement so long as the drawee bank acted in good faith in paying the check. Cases governed by subsection (b) are illustrated by Cases #1 through #5 in Comment 2. In Cases #1, #2, and #3 there is no forgery of the check, thus the drawer of the check takes the loss if there is no lack of good faith by the banks involved. Cases #4 and #5 are forged check cases. Depositary Bank is entitled to retain the proceeds of the check if it didn't know about the forgery. Under Section 3-418 the drawee bank is not entitled to recover

from Depositary Bank on the basis of payment by mistake because Depositary Bank took the check in good faith and gave value for the check when the credit given for the check was withdrawn. And there is no breach of warranty under Section 3-417(a)(1) or (3) or 4-208(a)(1) or (3). Unless Section 3-406 applies the loss is taken by the drawee bank if a forged check is paid, and that is the result in Case #5. In Case #4 the loss is taken by Corporation, the drawer, because an agreement between Corporation and the drawee bank allowed the bank to debit Corporation's account despite the unauthorized use of the check-writing machine.

If a check payable to an impostor, fictitious payee, or payee not intended to have an interest in the check is paid, the effect of subsections (a) and (b) is to place the loss on the drawer of the check rather than on the drawee or the depositary bank that took the check for collection. Cases governed by subsection (a) always involve fraud, and fraud is almost always involved in cases governed by subsection (b). The drawer is in the best position to avoid the fraud and thus should take the loss. This is true in Case #1, Case #2, and Case #3. But in some cases the person taking the check might have detected the fraud and thus have prevented the loss by the exercise of ordinary care. In those cases, if that person failed to exercise ordinary care, it is reasonable that that person bear loss to the extent the failure contributed to the loss. Subsection (d) is intended to reach that result. It allows the person who suffers loss as a result of payment of the check to recover from the person who failed to exercise ordinary care. In Case #1, Case #2, and Case #3, the person suffering the loss is Corporation, the drawer of the check. In each case the most likely defendant is the depositary bank that took the check and failed to exercise ordinary care. In those cases, the drawer has a cause of action against the offending bank to recover a portion of the loss. The amount of loss to be allocated to each party is left to the trier of fact. Ordinary care is defined in Section 3-103(a)(7). An example of the type of conduct by a depositary bank that could give rise to recovery under subsection (d) is discussed in Comment 4 to Section 3-405. That Comment addresses the last sentence of Section 3-405(b) which is similar to Section 3-404(d).

In Case #1, Case #2, and Case #3, there was no forgery of the drawer's signature. But cases involving checks payable to a fictitious payee or a payee not intended to have an interest in the check are often forged check

cases as well. Examples are Case #4 and Case #5. Normally, the loss in forged check cases is on the drawee bank that paid the check. Case #5 is an example. In Case #4 the risk with respect to the forgery is shifted to the drawer because of the agreement between the drawer and the drawee bank. The doctrine that prevents a drawee bank from recovering payment with respect to a forged check if the payment was made to a person who took the check for value and in good faith is incorporated into Section 3-418 and Sections 3-417(a)(3) and 4-208(a)(3). This doctrine is based on the assumption that the depositary bank normally has no way of detecting the forgery because the drawer is not that bank's customer. On the other hand, the drawee bank, at least in some cases, may be able to detect the forgery by comparing the signature on the check with the specimen signature that the drawee has on file. But in some forged check cases the depositary bank is in a position to detect the fraud. Those cases typically involve a check payable to a fictitious payee or a payee not intended to have an interest in the check. Subsection (d) applies to those cases. If the depositary bank failed to exercise ordinary care and the failure substantially contributed to the loss, the drawer in Case #4 or the drawee bank in Case #5 has a cause of action against the depositary bank under subsection (d). Comment 4 to Section 3-405 can be used as a guide to the type of conduct that could give rise to recovery under Section 3-404(d).

§ 28-3-405. Employer's responsibility for fraudulent indorsement by employee. — (1) In this section:

(a) "Employee" includes an independent contractor and employee of an independent contractor retained by the employer.

(b) "Fraudulent indorsement" means (i) in the case of an instrument payable to the employer, a forged indorsement purporting to be that of the employer, or (ii) in the case of an instrument with respect to which the employer is the issuer, a forged indorsement purporting to be that of the person identified as payee.

(c) "Responsibility" with respect to instruments means authority (i) to sign or indorse instruments on behalf of the employer, (ii) to process instruments received by the employer for bookkeeping purposes, for deposit to an account, or for other disposition, (iii) to prepare or process instruments for issue in the name of the employer, (iv) to supply information determining the names or addresses of payees of instruments to be issued in the name of the employer, (v) to control the disposition of instruments to be issued in the name of the employer, or (vi) to act otherwise with respect to instruments in a responsible capacity. "Responsibility" does not include authority that merely allows an employee to have access to instruments or blank or incomplete instrument forms that are being stored or transported or are part of incoming or outgoing mail, or similar access.

(2) For the purpose of determining the rights and liabilities of a person who, in good faith, pays an instrument or takes it for value or for collection, if an employer entrusted an employee with responsibility with respect to the instrument and the employee or a person acting in concert with the employee makes a fraudulent indorsement of the instrument, the indorsement is effective as the indorsement of the person to whom the instrument is payable if it is made in the name of that person. If the person paying the instrument or taking it for value or for collection fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss resulting from the fraud, the person bearing

the loss may recover from the person failing to exercise ordinary care to the extent the failure to exercise ordinary care contributed to the loss.

(3) Under subsection (2) of this section, an indorsement is made in the name of the person to whom an instrument is payable if (i) it is made in a name substantially similar to the name of that person, or (ii) the instrument, whether or not indorsed, is deposited in a depositary bank to an account in a name substantially similar to the name of that person.

History.

I.C., § 28-3-405, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-405 was repealed. See Prior Laws, § 28-3-101.

Official Comment

1. Section 3-405 is addressed to fraudulent indorsements made by an employee with respect to instruments with respect to which the employer has given responsibility to the employee. It covers two categories of fraudulent indorsements: indorsements made in the name of the employer to instruments payable to the employer and indorsements made in the name of payees of instruments issued by the employer. This section applies to instruments generally but normally the instrument will be a check. Section 3-405 adopts the principle that the risk of loss for fraudulent indorsements by employees who are entrusted with responsibility with respect to checks should fall on the employer rather than the bank that takes the check or pays it, if the bank was not negligent in the transaction. Section 3-405 is based on the belief that the employer is in a far better position to avoid the loss by care in choosing employees, in supervising them, and in adopting other measures to prevent forged indorsements on instruments payable to the employer or fraud in the issuance of instruments in the name of the employer. If the bank failed to exercise ordinary care, subsection (b) allows the employer to shift loss to the bank to the extent the bank's failure to exercise ordinary care contributed to the loss. "Ordinary care" is defined in

Section 3-103(a)(7). The provision applies regardless of whether the employer is negligent.

The first category of cases governed by Section 3-405 are those involving indorsements made in the name of payees of instruments issued by the employer. In this category, Section 3-405 includes cases that were covered by former Section 3-405(1)(c). The scope of Section 3-405 in revised Article 3 is, however, somewhat wider. It covers some cases not covered by former Section 3-405(1)(c) in which the entrusted employee makes a forged indorsement to a check drawn by the employer. An example is Case #6 in Comment 3. Moreover, a larger group of employees is included in revised Section 3-405. The key provision is the definition of "responsibility" in subsection (a)(1) which identifies the kind of responsibility for the fraudulent acts of that employee. An employer can insure this risk by employee fidelity bonds.

The second category of cases governed by Section 3-405 — fraudulent indorsements of the name of the employer to instruments payable to the employer — were covered in former Article 3 by Section 3-406. Under former Section 3-406, the employer took the loss only if negligence of the employer could be proved. Under revised Article 3, Section 3-406 need not be used with respect to forgeries of the employer's indorsement. Section 3-405 imposes the loss on the employer without proof of negligence.

2. With respect to cases governed by former Section 3-405(1)(c), Section 3-405 is more favorable to employers in one respect. The bank was entitled to the preclusion provided by former Section 3-405(1)(c) if it took the check in good faith. The fact that the bank acted negligently did not shift the loss to the bank so long as the bank acted in good faith. Under revised Section 3-405 the loss may be recovered from the bank to the extent the failure of the bank to exercise ordinary care contributed to the loss.

3. Section 3-404(b) and Section 3-405 both apply to cases of employee fraud. Section 3-404(b) is not limited to cases of employee fraud, but most of the cases to which it applies will be cases of employee fraud. The following cases illustrate the application of Section 3-405. In each case it is assumed that the bank that took the check acted in good faith and was not negligent.

Case #1. Janitor, an employee of Employer, steals a check for a very large amount payable to Employer after finding it on a desk in one of Employer's offices. Janitor forges Employer's indorsement on the check and obtains payment. Since Janitor was not entrusted with "responsibility" with respect to the check, Section 3-405 does not apply. Section 3-406 might apply to this case. The issue would be whether Employer was negligent in safeguarding the check. If not, Employer could assert that the indorsement was forged and bring an action for conversion against the depositary or payor bank under Section 3-420.

Case #2. X is Treasurer of Corporation and is authorized to write checks on behalf of Corporation by signing X's name as Treasurer. X draws a check in the name of Corporation and signs X's name as Treasurer. The check is made payable to X. X then indorses the check and obtains payment. Assume that Corporation did not owe any money to X and did not authorize X to write the check. Although the writing of the check was not authorized, Corporation is bound as drawer of the check because X had authority to sign checks on behalf of Corporation. This result follows from agency law and Section 3-402(a). Section 3-405 does not apply in this case because there is no forged indorsement. X was payee of the check so the indorsement is valid. Section 3-110(a).

Case #3. The duties of Employee, a bookkeeper, include posting the amounts of checks payable to Employer to the accounts of the drawers of the checks. Employee steals a check payable to Employer which was entrusted to Employee and forges Employer's indorsement. The check is deposited by Employee to an account in Depositary Bank which Employee opened in the same name as Employer, and the check is honored by the drawee bank. The indorsement is effective as Employer's indorsement because Employee's duties include processing checks for bookkeeping purposes. Thus, Employee is entrusted with "responsibility" with respect to the check. Neither Depositary Bank nor the drawee bank is liable to Employer for conversion of the check. The same result follows if Employee deposited the check in the account in Depositary Bank without indorsement. Section 4-205(a). Under subsection (c) deposit in a depositary bank in an account in a name substantially similar to that of Employer is the equivalent of an indorsement in the name of Employer.

Case #4. Employee's duties include stamping Employer's unrestricted blank indorsement on checks received by Employer and depositing them in Employer's bank account. After stamping Employer's unrestricted blank indorsement on a check, Employee steals the check and deposits it in Employee's personal bank account. Section 3-405 doesn't apply because there is no forged indorsement. Employee is authorized by Employer to indorse Employer's checks. The fraud by Employee is not the indorsement but rather the theft of the indorsed check. Whether Employer has a cause of action against the bank in which the check was deposited is determined by whether the bank had notice of the breach of fiduciary duty by Employee. The issue is determined under Section 3-307.

Case #5. The computer that controls Employer's check-writing machine was programmed to cause a check to be issued to Supplier Co., to which money was owed by Employer. The address of Supplier Co. was included in the information in the computer. Employee is an accounts payable clerk whose duties include entering information into the computer. Employee fraudulently changed the address of Supplier Co. in the computer data bank to an address of Employee. The check was subsequently produced by the check-writing machine and mailed to the address that Employee had entered into the computer. Employee obtained possession of the check, indorsed it in the name of Supplier Co., and deposited it to an account in Depositary Bank which Employee opened in the name "Supplier Co.". The check was honored by the drawee bank. The indorsement is effective under Section 3-405(b) because Employee's duties allowed Employee to supply information determining the address of the payee of the check. An employee that is entrusted with duties that enable the employee to determine the address to which a check is to be sent controls the disposition of the check and facilitates forgery of the indorsement. The employer is held responsible. The drawee may debit the account of Employer for the amount of the check. There is no breach of warranty by Depositary Bank under Section 3-417(a)(1) or 4-208(a)(1).

Case #6. Treasurer is authorized to draw checks in behalf of Corporation. Treasurer draws a check of Corporation payable to Supplier Co., a company that sold goods to Corporation. The check was issued to

pay the price of these goods. At the time the check was signed Treasurer had no intention of stealing the check. Later, Treasurer stole the check, indorsed it in the name "Supplier Co." and obtained payment by depositing it to an account in Depositary Bank which Treasurer opened in the name "Supplier Co.". The indorsement is effective under Section 3-405(b). Section 3-404(b) does not apply to this case.

Case #7. Checks of Corporation are signed by Treasurer in behalf of Corporation as drawer. Clerk's duties include the preparation of checks for issue by Corporation. Clerk prepares a check payable to the order of Supplier Co. for Treasurer's signature. Clerk fraudulently informs Treasurer that the check is needed to pay a debt owed to Supplier Co., a company that does business with Corporation. No money is owed to Supplier Co. and Clerk intends to steal the check. Treasurer signs it and returns it to Clerk for mailing. Clerk does not indorse the check but deposits it to an account in Depositary Bank which Clerk opened in the name "Supplier Co.". The check is honored by the drawee bank. Section 3-404(b)(i) does not apply to this case because Clerk, under Section 3-110(a), is not the person whose intent determines to whom the check is payable. But Section 3-405 does apply and it treats the deposit by Clerk as an effective indorsement by Clerk because Clerk was entrusted with responsibility with respect to the check. If Supplier Co. is a fictitious person Section 3-404(b)(ii) applies. But the result is the same. Clerk's deposit is treated as an effective indorsement of the check whether Supplier Co. is a fictitious or a real person or whether money was or was not owing to Supplier Co. The drawee bank may debit the account of Corporation for the amount of the check and there is no breach of warranty by Depositary Bank under Section 3-417(1)(a).

4. The last sentence of subsection (b) is similar to subsection (d) of Section 3-404 which is discussed in Comment 3 to Section 3-404. In Case #5, Case #6, or Case #7 the depositary bank may have failed to exercise ordinary care when it allowed the employee to open an account in the name "Supplier Co.," to deposit checks payable to "Supplier Co." in that account, or to withdraw funds from that account that were proceeds of checks payable to Supplier Co. Failure to exercise ordinary care is to be determined in the context of all the facts relating to the bank's conduct with respect to the bank's collection of the check. If the trier of fact finds that there was

such a failure and that the failure substantially contributed to loss, it could find the depositary bank liable to the extent the failure contributed to the loss. The last sentence of subsection (b) can be illustrated by an example. Suppose in Case #5 that the check is not payable to an obscure "Supplier Co." but rather to a well-known national corporation. In addition, the check is for a very large amount of money. Before depositing the check, Employee opens an account in Depositary Bank in the name of the corporation and states to the person conducting the transaction for the bank that Employee is manager of a new office being opened by the corporation. Depositary Bank opens the account without requiring Employee to produce any resolutions of the corporation's board of directors or other evidence of authorization of Employee to act for the corporation. A few days later, the check is deposited, the account is credited, and the check is presented for payment. After Depositary Bank receives payment, it allows Employee to withdraw the credit by a wire transfer to an account in a bank in a foreign country. The trier of fact could find that Depositary Bank did not exercise ordinary care and that the failure to exercise ordinary care contributed to the loss suffered by Employer. The trier of fact could allow recovery by Employer from Depositary Bank for all or part of the loss suffered by Employer.

§ 28-3-406. Negligence contributing to forged signature or alteration of instrument. — (1) A person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection.

(2) Under subsection (1) of this section, if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure substantially contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

(3) Under subsection (1) of this section, the burden of proving failure to exercise ordinary care is on the person asserting the preclusion. Under subsection (2) of this section, the burden of proving failure to exercise ordinary care is on the person precluded.

History.

I.C., § 28-3-406, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-406 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

In general.

Liability of drawee.

Negligence by depositor.

Reasonable commercial standards.

In General.

A bank is bound to know the signatures of its depositors and payment of a forged check, however skillfully the forgery is executed, cannot be debited against the depositor if he is wholly free from neglect or fault. Mercantile Stores Co. v. Idaho First Nat'l Bank, 102 Idaho 820, 641 P.2d 1007 (Ct. App. 1982).

Liability of Drawee.

Where the evidence, in an action by a corporate depositor against the drawee bank to have the corporation's account credited for forged checks paid by the bank, supported the finding that the depositor was not negligent in contributing to the forgeries, the drawee bank was liable to the depositor for amounts paid on the checks which were forged by manually tracing a facsimile signature from another corporate check, even though the corporation had authorized the bank to pay checks which were impressed with a facsimile signature, because placing a traced signature on the checks was not the same as mechanically impressing the signature on the checks. Mercantile Stores Co. v. Idaho First Nat'l Bank, 102 Idaho 820, 641 P.2d 1007 (Ct. App. 1982).

Negligence by Depositor.

A depositor may be precluded by his own negligence from asserting lack of responsibility for losses to his account which result from forged checks, when the drawee bank pays the forged instruments in good faith and in accordance with reasonable commercial standards; such preclusive negligence can occur either before a check is honored by the bank, where the depositor substantially contributes to the making of an unauthorized signature, or after a check has been honored by the bank, where the depositor fails with reasonable care and promptness to examine his bank statements, discover an unauthorized signature, or report the discovery to the bank. Mercantile Stores Co. v. Idaho First Nat'l Bank, 102 Idaho 820, 641 P.2d 1007 (Ct. App. 1982).

Reasonable Commercial Standards.

The determination of what constitutes reasonable commercial standards is a mixed question of fact and law. Valley Bank v. Neibaur, 120 Idaho 733, 819 P.2d 1133 (1991).

Where the UCC provided no standard concerning the payment of a check by issuing a cashier's check payable to the same payee without bank requiring indorsement by the person presenting the check for payment, the unrebutted testimony of the operations officer of bank established what reasonable banking standards were. Valley Bank v. Neibaur, 120 Idaho 733, 819 P.2d 1133 (1991).

In action against bank for payment of forged checks where no issue was raised on appeal by either party concerning instruction to jury that the term "reasonable commercial standards" as used in this section and "ordinary care" as used in § 28-4-406 were equivalent, evidence supported finding that, except for the one instance, ordinary care was used by bank. Basterrechea Distrib., Inc. v. Idaho State Bank, 122 Idaho 572, 836 P.2d 518 (1992).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 554 et seq.

ALR. — What amounts to negligence contributing to alterations or unauthorized signature under UCC § 3-406. 67 A.L.R.3d 144.

Official Comment

1. Section 3-406(a) is based on former Section 3-406. With respect to alteration, Section 3-406 adopts the doctrine of *Young v. Grote,* 4 Bing. 253 (1827), which held that a drawer who so negligently draws an instrument as to facilitate its material alteration is liable to a drawee who pays the altered instrument in good faith. Under Section 3-406 the doctrine is expanded to apply not only to drafts but to all instruments. It includes in the protected class any "person who, in good faith, pays the instrument or takes it for value or for collection." Section 3-406 rejects decisions holding that the maker of a note owes no duty of care to the holder because at the time the instrument is issued there is no contract between them. By issuing the instrument and "setting it afloat upon a sea of strangers" the maker or drawer voluntarily enters into a relation with later holders which justifies imposition of a duty of care. In this respect an instrument so negligently drawn as to facilitate alteration does not differ in principle from an instrument containing blanks which may be filled. Under Section 3-407 a

person paying an altered instrument or taking it for value, in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms. If negligence of the obligor substantially contributes to an alteration, this section gives the holder or the payor the alternative right to treat the altered instrument as though it had been issued in the altered form.

No attempt is made to define particular conduct that will constitute "failure to exercise ordinary care [that] substantially contributes to an alteration." Rather, "ordinary care" is defined in Section 3-103(a)(7) in general terms. The question is left to the court or the jury for decision in the light of the circumstances in the particular case including reasonable commercial standards that may apply.

Section 3-406 does not make the negligent party liable in tort for damages resulting from the alteration. If the negligent party is estopped from asserting the alteration the person taking the instrument is fully protected because the taker can treat the instrument as having been issued in the altered form.

2. Section 3-406 applies equally to a failure to exercise ordinary care that substantially contributes to the making of a forged signature on an instrument. Section 3-406 refers to "forged signature" rather than "unauthorized signature" that appeared in former Section 3-406 because it more accurately describes the scope of the provision. Unauthorized signature is a broader concept that includes not only forgery but also the signature of an agent which does not bind the principal under the law of agency. The agency cases are resolved independently under agency law. Section 3-406 is not necessary in those cases.

The "substantially contributes" test of former Section 3-406 is continued in this section in preference to a "direct and proximate cause" test. The "substantially contributes" test is meant to be less stringent than a "direct and proximate cause" test. Under the less stringent test the preclusion should be easier to establish. Conduct "substantially contributes" to a material alteration or forged signature if it is a contributing cause of the alteration or signature and a substantial factor in bringing it about. The analysis of "substantially contributes" in former Section 3-406 by the court in *Thompson Maple Products v. Citizens National Bank of Corry,* 234 A.2d

32 (Pa. Super. Ct. 1967), states what is intended by the use of the same words in revised Section 3-406(b). Since Section 3-404(d) and Section 3-405(b) also use the words "substantially contributes" the analysis of these words also applies to those provisions.

3. The following cases illustrate the kind of conduct that can be the basis of a preclusion under Section 3-406(a):

Case #1. Employer signs checks drawn on Employer's account by use of a rubber stamp of Employer's signature. Employer keeps the rubber stamp along with Employer's personalized blank check forms in an unlocked desk drawer. An unauthorized person fraudulently uses the check forms to write checks on Employer's account. The checks are signed by use of the rubber stamp. If Employer demands that Employer's account in the drawee bank be recredited because the forged check was not properly payable, the drawee bank may defend by asserting that Employer is precluded from asserting the forgery. The trier of fact could find that Employer failed to exercise ordinary care to safeguard the rubber stamp and the check forms and that the failure substantially contributed to the forgery of Employer's signature by the unauthorized use of the rubber stamp.

Case #2. An insurance company draws a check to the order of Sarah Smith in payment of a claim of a policyholder, Sarah Smith, who lives in Alabama. The insurance company also has a policyholder with the same name who lives in Illinois. By mistake, the insurance company mails the check to the Illinois Sarah Smith who indorses the check and obtains payment. Because the payee of the check is the Alabama Sarah Smith, the indorsement by the Illinois Sarah Smith is a forged indorsement. Section 3-110(a). The trier of fact could find that the insurance company failed to exercise ordinary care when it mailed the check to the wrong person and that the failure substantially contributed to the making of the forged indorsement. In that event the insurance company could be precluded from asserting the forged indorsement against the drawee bank that honored the check.

Case #3. A company writes a check for $10. The figure "10" and the word "ten" are typewritten in the appropriate spaces on the check form. A large blank space is left after the figure and the word. The payee of the

check, using a typewriter with a typeface similar to that used on the check, writes the word "thousand" after the word "ten" and a comma and three zeros after the figure "10." The drawee bank in good faith pays $10,000 when the check is presented for payment and debits the account of the drawer in that amount. The trier of fact could find that the drawer failed to exercise ordinary care in writing the check and that the failure substantially contributed to the alteration. In that case the drawer is precluded from asserting the alteration against the drawee if the check was paid in good faith.

4. Subsection (b) differs from former Section 3-406 in that it adopts a concept of comparative negligence. If the person precluded under subsection (a) proves that the person asserting the preclusion failed to exercise ordinary care and that failure substantially contributed to the loss, the loss may be allocated between the two parties on a comparative negligence basis. In the case of a forged indorsement the litigation is usually between the payee of the check and the depositary bank that took the check for collection. An example is a case like Case #1 of Comment 3 to Section 3-405. If the trier of fact finds that Employer failed to exercise ordinary care in safeguarding the check and that the failure substantially contributed to the making of the forged indorsement, subsection (a) of Section 3-406 applies. If Employer brings an action for conversion against the depositary bank that took the checks from the forger, the depositary bank could assert the preclusion under subsection (a). But suppose the forger opened an account in the depositary bank in a name identical to that of Employer, the payee of the check, and then deposited the check in the account. Subsection (b) may apply. There may be an issue whether the depositary bank should have been alerted to possible fraud when a new account was opened for a corporation shortly before a very large check payable to a payee with the same name is deposited. Circumstances surrounding the opening of the account may have suggested that the corporation to which the check was payable may not be the same as the corporation for which the account was opened. If the trier of fact finds that collecting the check under these circumstances was a failure to exercise ordinary care, it could allocate the loss between the depositary bank and Employer, the payee.

§ 28-3-407. Alteration. — (1) "Alteration" means (i) an unauthorized change in an instrument that purports to modify in any respect the obligation of a party, or (ii) an unauthorized addition of words or numbers or other change to an incomplete instrument relating to the obligation of a party.

(2) Except as provided in subsection (3) of this section, an alteration fraudulently made discharges a party whose obligation is affected by the alteration unless that party assents or is precluded from asserting the alteration. No other alteration discharges a party, and the instrument may be enforced according to its original terms.

(3) A payor bank or drawee paying a fraudulently altered instrument or a person taking it for value, in good faith and without notice of the alteration, may enforce rights with respect to the instrument (i) according to its original terms, or (ii) in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed.

History.

I.C., § 28-3-407, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-407 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

Showing required.

Alterations in a Blank Printed Form.

Changes in a blank printed form used to prepare a counterfeit cashier's check did not constitute alterations within an exclusion of liability for forgery or alterations of checks or drafts in a blanket bank bond. United Pac. Ins. Co. v. Idaho First Nat'l Bank, 378 F.2d 62 (9th Cir. 1967).

Blank Wrongfully Filled Out.

Holder who took note for past due indebtedness, in which blank has been wrongfully filled out, was not a holder in due course. Consolidated Wagon & Mach. Co. v. Housman, 38 Idaho 343, 221 P. 143 (1923).

Burden to Explain Alteration.

Where an alteration was apparent on the face of an instrument, the burden was on the party claiming under it to explain the alteration. Exchange State Bank v. Taber, 26 Idaho 723, 145 P. 1090 (1915).

Evidence of Alteration Precluded.

Admission in defendant's answer of the execution and delivery of notes and admission in evidence in the same condition precluded evidence of alteration. Exchange State Bank v. Taber, 26 Idaho 723, 145 P. 1090 (1915).

Question for Jury.

Whether alterations were made by maker or with his consent, or whether plaintiff had notice of such alterations or such knowledge as would put him on inquiry, were questions for jury. GMAC v. Talbott, 39 Idaho 707, 230 P. 30 (1924).

Showing Required.

Parties who made or executed instrument may have made or assented to alteration before its execution and holder may not have been able to prove that fact. All that was required of him was to show that instrument had not been altered since it came to his hands. GMAC v. Talbott, 39 Idaho 707, 230 P. 30 (1924).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 547 et seq.

Official Comment

1. This provision restates former Section 3-407. Former Section 3-407 defined a "material" alteration as any alteration that changes the contract of the parties in any respect. Revised Section 3-407 refers to such a change as an alteration. As under subsection (2) of former Section 3-407, discharge because of alteration occurs only in the case of an alteration fraudulently made. There is no discharge if a blank is filled in the honest belief that it is authorized or if a change is made with a benevolent motive such as a desire to give the obligor the benefit of a lower interest rate. Changes favorable to the obligor are unlikely to be made with any fraudulent intent, but if such an intent is found the alteration may operate as a discharge.

Discharge is a personal defense of the party whose obligation is modified and anyone whose obligation is not affected is not discharged. But if an alteration discharges a party there is also discharge of any party having a right of recourse against the discharged party because the obligation of the party with the right of recourse is affected by the alteration. Assent to the alteration given before or after it is made will prevent the party from asserting the discharge. The phrase "or is precluded from asserting the alteration" in subsection (b) recognizes the possibility of an estoppel or other ground barring the defense which does not rest on assent.

2. Under subsection (c) a person paying a fraudulently altered instrument or taking it for value, in good faith and without notice of the alteration, is not affected by a discharge under subsection (b). The person paying or taking the instrument may assert rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument that is altered by unauthorized completion, according to its terms as completed. If blanks are filled or an incomplete instrument is otherwise completed, subsection (c) places the loss upon the party who left the instrument incomplete by permitting enforcement in its completed form. This result is intended even though the instrument was stolen from the issuer and completed after the theft.

§ 28-3-408. Drawee not liable on unaccepted draft. — A check or other draft does not of itself operate as an assignment of funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until the drawee accepts it.

History.

I.C., § 28-3-408, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-408 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law Nature and Effect of Check.

An appellant's deposit with the clerk of the supreme court of his uncertified personal check is not equivalent to a deposit of money in lieu of an appeal bond. Martinson v. Martinson, 90 Idaho 490, 414 P.2d 204 (1966).

Official Comment 1. This section is a restatement of former Section 3-409(1). Subsection (2) of former Section 3-409 is deleted as misleading and superfluous. Comment 3 says of subsection (2): "It is intended to make it clear that this section does not in any way affect any liability which may arise apart from the instrument." In reality subsection (2) did not make anything clear and was a source of confusion. If all it meant was that a bank that has not certified a check may engage in other conduct that might make it liable to a holder, it stated the obvious and was superfluous. Section 1-103 is adequate to cover those cases.

2. Liability with respect to drafts may arise under other law. For example, Section 4-302 imposes liability on a payor bank for late return of an item.

§ 28-3-409. Acceptance of draft — Certified check. — (1) "Acceptance" means the drawee's signed agreement to pay a draft as presented. It must be written on the draft and may consist of the drawee's signature alone. Acceptance may be made at any time and becomes effective when notification pursuant to instructions is given or the accepted draft is delivered for the purpose of giving rights on the acceptance to any person.

(2) A draft may be accepted although it has not been signed by the drawer, is otherwise incomplete, is overdue, or has been dishonored.

(3) If a draft is payable at a fixed period after sight and the acceptor fails to date the acceptance, the holder may complete the acceptance by supplying a date in good faith.

(4) "Certified check" means a check accepted by the bank on which it is drawn. Acceptance may be made as stated in subsection (1) of this section or by a writing on the check which indicates that the check is certified. The drawee of a check has no obligation to certify the check, and refusal to certify is not dishonor of the check.

History.

I.C., § 28-3-409, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-409 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

Acceptance.

Acceptance may have been implied from conduct clearly indicative of intention to accept. McLaughlin's Store v. Copeman, 50 Idaho 214, 294 P. 523 (1930).

Official Comment

1. The first three subsections of Section 3-409 are a restatement of former Section 3-410. Subsection (d) adds a definition of certified check which is a type of accepted draft.

2. Subsection (a) states the generally recognized rule that the mere signature of the drawee on the instrument is a sufficient acceptance. Customarily the signature is written vertically across the face of the instrument, but since the drawee has no reason to sign for any other purpose a signature in any other place, even on the back of the instrument, is sufficient. It need not be accompanied by such words as "Accepted," "Certified," or "Good." It must not, however, bear any words indicating an intent to refuse to honor the draft. The last sentence of subsection (a) states the generally recognized rule that an acceptance written on the draft takes effect when the drawee notifies the holder or gives notice according to instructions.

3. The purpose of subsection (c) is to provide a definite date of payment if none appears on the instrument. An undated acceptance of a draft payable "thirty days after sight" is incomplete. Unless the acceptor writes in a different date the holder is authorized to complete the acceptance according to the terms of the draft by supplying a date of acceptance. Any date supplied by the holder is effective if made in good faith.

4. The last sentence of subsection (d) states the generally recognized rule that in the absence of agreement a bank is under no obligation to certify a check. A check is a demand instrument calling for payment rather than acceptance. The bank may be liable for breach of any agreement with the drawer, the holder, or any other person by which it undertakes to certify. Its liability is not on the instrument, since the drawee is not so liable until acceptance. Section 3-408. Any liability is for breach of the separate agreement.

§ 28-3-410. Acceptance varying draft. — (1) If the terms of a drawee's acceptance vary from the terms of the draft as presented, the holder may refuse the acceptance and treat the draft as dishonored. In that case, the drawee may cancel the acceptance.

(2) The terms of a draft are not varied by an acceptance to pay at a particular bank or place in the United States, unless the acceptance states that the draft is to be paid only at that bank or place.

(3) If the holder assents to an acceptance varying the terms of a draft, the obligation of each drawer and indorser that does not expressly assent to the acceptance is discharged.

History.

I.C., § 28-3-410, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-410 was repealed. See Prior Laws, § 28-3-101.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 344 et seq.

Official Comment

1. This section is a restatement of former Section 3-412. It applies to conditional acceptances, acceptances for part of the amount, acceptances to pay at a different time from that required by the draft, or to the acceptance of less than all of the drawees. It applies to any other engagement changing the essential terms of the draft. If the drawee makes a varied acceptance the holder may either reject it or assent to it. The holder may reject by insisting on acceptance of the draft as presented. Refusal by the drawee to accept the draft as presented is dishonor. In that event the drawee is not bound by the varied acceptance and is entitled to have it canceled.

If the holder assents to the varied acceptance, the drawee's obligation as acceptor is according to the terms of the varied acceptance. Under subsection (c) the effect of the holder's assent is to discharge any drawer or indorser who does not also assent. The assent of the drawer or indorser must be affirmatively expressed. Mere failure to object within a reasonable time is not assent which will prevent the discharge.

2. Under subsection (b) an acceptance does not vary from the terms of the draft if it provides for payment at any particular bank or place in the United States unless the acceptance states that the draft is to be paid only at such bank or place. Section 3-501(b)(1) states that if an instrument is payable at a bank in the United States presentment must be made at the place of payment (Section 3-111) which in this case is at the designated bank.

§ 28-3-411. Refusal to pay cashier's checks, teller's checks, and certified checks. — (1) In this section, "obligated bank" means the acceptor of a certified check or the issuer of a cashier's check or teller's check bought from the issuer.

(2) If the obligated bank wrongfully (i) refuses to pay a cashier's check or certified check, (ii) stops payment of a teller's check, or (iii) refuses to pay a dishonored teller's check, the person asserting the right to enforce the check is entitled to compensation for expenses and loss of interest resulting from the nonpayment and may recover consequential damages if the obligated bank refuses to pay after receiving notice of particular circumstances giving rise to the damages.

(3) Expenses or consequential damages under subsection (2) of this section are not recoverable if the refusal of the obligated bank to pay occurs because (i) the bank suspends payments, (ii) the obligated bank asserts a claim or defense of the bank that it has reasonable grounds to believe is available against the person entitled to enforce the instrument, (iii) the obligated bank has a reasonable doubt whether the person demanding payment is the person entitled to enforce the instrument, or (iv) payment is prohibited by law.

History.

I.C., § 28-3-411, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-411 was repealed. See Prior Laws, § 28-3-101.

Official Comment

1. In some cases a creditor may require that the debt be paid by an obligation of a bank. The debtor may comply by obtaining certification of the debtor's check, but more frequently the debtor buys from a bank a cashier's check or teller's check payable to the creditor. The check is taken

by the creditor as a cash equivalent on the assumption that the bank will pay the check. Sometimes, the debtor wants to retract payment by inducing the obligated bank not to pay. The typical case involves a dispute between the parties to the transaction in which the check is given in payment. In the case of a certified check or cashier's check, the bank can safely pay the holder of the check despite notice that there may be an adverse claim to the check (Section 3-602). It is also clear that the bank that sells a teller's check has no duty to order the bank on which it is drawn not to pay it. A debtor using any of these types of checks has no right to stop payment. Nevertheless, some banks will refuse payment as an accommodation to a customer. Section 3-411 is designed to discourage this practice.

2. The term "obligated bank" refers to the issuer of the cashier's check or teller's check and the acceptor of the certified check. If the obligated bank wrongfully refuses to pay, it is liable to pay for expenses and loss of interest resulting from the refusal to pay. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses * resulting from the nonpayment." In addition the bank may be liable to pay consequential damages if it has notice of the particular circumstances giving rise to the damages.

3. Subsection (c) provides that expenses or consequential damages are not recoverable if the refusal to pay is because of the reasons stated. The purpose is to limit that recovery to cases in which the bank refuses to pay even though its obligation to pay is clear and it is able to pay. Subsection (b) applies only if the refusal to honor the check is wrongful. If the bank is not obliged to pay there is no recovery. The bank may assert any claim or defense that it has, but normally the bank would not have a claim or defense. In the usual case it is a remitter that is asserting a claim to the check on the basis of a rescission of negotiation to the payee under Section 3-202. See Comment 2 to Section 3-201. The bank can assert that claim if there is compliance with Section 3-305(c), but the bank is not protected from damages under subsection (b) if the claim of the remitter is not upheld. In that case, the bank is insulated from damages only if payment is enjoined under Section 3-602(b)(1). Subsection (c)(iii) refers to cases in which the bank may have a reasonable doubt about the identity of the person demanding payment. For example, a cashier's check is payable to

"Supplier Co." The person in possession of the check presents it for payment over the counter and claims to be an officer of Supplier Co. The bank may refuse payment until it has been given adequate proof that the presentment in fact is being made for Supplier Co., the person entitled to enforce the check.

§ 28-3-412. Obligation of issuer of note or cashier's check. — The issuer of a note or cashier's check or other draft drawn on the drawer is obliged to pay the instrument (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the issuer signed an incomplete instrument, according to its terms when completed, to the extent stated in sections 28-3-115 and 28-3-407[, Idaho Code]. The obligation is owed to a person entitled to enforce the instrument or to an indorser who paid the instrument under section 28-3-415[, Idaho Code].

History.

I.C., § 28-3-412, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-412 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions at the end of each sentence were added by the compiler to conform to the statutory citation style.

Official Comment

1. The obligations of the maker, acceptor, drawer, and indorser are stated in four separate sections. Section 3-412 states the obligation of the maker of a note and is consistent with former Section 3-413(1). Section 3-412 also applies to the issuer of a cashier's check or other draft drawn on the drawer. Under former Section 3-118(a), since a cashier's check or other draft drawn on the drawer was "effective as a note," the drawer was liable under former Section 3-413(1) as a maker. Under Sections 3-103(a)(6) and 3-104(f) a cashier's check or other draft drawn on the drawer is treated as a draft to reflect common commercial usage, but the liability of the drawer is stated by Section 3-412 as being the same as that of the maker of a note rather

than that of the drawer of a draft. Thus, Section 3-412 does not in substance change former law.

2. Under Section 3-105(b) nonissuance of either a complete or incomplete instrument is a defense by a maker or drawer against a person that is not a holder in due course.

3. The obligation of the maker may be modified in the case of alteration if, under Section 3-406, the maker is precluded from asserting the alteration.

4. The rule of this section is similar to the rule of Article 39 of the Convention on International Bills of Exchange and International Promissory Notes.

§ 28-3-413. Obligation of acceptor. — (1) The acceptor of a draft is obliged to pay the draft (i) according to its terms at the time it was accepted, even though the acceptance states that the draft is payable "as originally drawn" or equivalent terms, (ii) if the acceptance varies the terms of the draft, according to the terms of the draft as varied, or (iii) if the acceptance is of a draft that is an incomplete instrument, according to its terms when completed, to the extent stated in sections 28-3-115 and 28-3-407[, Idaho Code]. The obligation is owed to a person entitled to enforce the draft or to the drawer or an indorser who paid the draft under section 28-3-414 or 28-3-415[, Idaho Code].

(2) If the certification of a check or other acceptance of a draft states the amount certified or accepted, the obligation of the acceptor is that amount. If (i) the certification or acceptance does not state an amount, (ii) the amount of the instrument is subsequently raised, and (iii) the instrument is then negotiated to a holder in due course, the obligation of the acceptor is the amount of the instrument at the time it was taken by the holder in due course.

History.

I.C., § 28-3-413, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-413 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsection (1) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law Failure of bank.

Parol evidence.

Trade acceptance.

Failure of Bank.

Where drawee bank received check as collecting agent and as drawee, and before its failure had not charged it to drawer's account, drawer was liable to payee although he had sufficient money on deposit to pay check. Davison v. Allen, 47 Idaho 405, 276 P. 43 (1929).

Parol Evidence.

Parol evidence to show that an apparent comaker signed as a witness to the other signatures was inadmissible. International Harvester Co. of Am. v. Beverland, 37 Idaho 782, 219 P. 201 (1923).

Trade Acceptance.

A trade acceptance drawn by the seller of goods and accepted by the buyer, payable to the order of payee designated by the drawer, was a negotiable instrument under which acceptor, by his acceptance, became primarily liable for payment. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 407 et seq.

Official Comment

Subsection (a) is consistent with former Section 3-413(1). Subsection (b) has primary importance with respect to certified checks. It protects the holder in due course of a certified check that was altered after certification and before negotiation to the holder in due course. A bank can avoid liability for the altered amount by stating on the check the amount the bank agrees to pay. The subsection applies to other accepted drafts as well. The rule of this section is similar to the rule of Articles 41 of the Convention on International Bills of Exchange and International Promissory Notes. Articles 42 and 43 of the Convention include more detailed rules that in many respects do not have parallels in this Article.

§ 28-3-414. Obligation of drawer. — (1) This section does not apply to cashier's checks or other drafts drawn on the drawer.

(2) If an unaccepted draft is dishonored, the drawer is obliged to pay the draft (i) according to its terms at the time it was issued or, if not issued, at the time it first came into possession of a holder, or (ii) if the drawer signed an incomplete instrument, according to its terms when completed, to the extent stated in sections 28-3-115 and 28-3-407[, Idaho Code]. The obligation is owed to a person entitled to enforce the draft or to an indorser who paid the draft under section 28-3-415[, Idaho Code].

(3) If a draft is accepted by a bank, the drawer is discharged, regardless of when or by whom acceptance was obtained.

(4) If a draft is accepted and the acceptor is not a bank, the obligation of the drawer to pay the draft if the draft is dishonored by the acceptor is the same as the obligation of an indorser under section 28-3-415(1) and (3)[, Idaho Code].

(5) If a draft states that it is drawn "without recourse" or otherwise disclaims liability of the drawer to pay the draft, the drawer is not liable under subsection (2) of this section to pay the draft if the draft is not a check. A disclaimer of the liability stated in subsection (2) of this section is not effective if the draft is a check.

(6) If (i) a check is not presented for payment or given to a depositary bank for collection within thirty (30) days after its date, (ii) the drawee suspends payments after expiration of the thirty (30) day period without paying the check, and (iii) because of the suspension of payments, the drawer is deprived of funds maintained with the drawee to cover payment of the check, the drawer to the extent deprived of funds may discharge its obligation to pay the check by assigning to the person entitled to enforce the check the rights of the drawer against the drawee with respect to the funds.

History.

I.C., § 28-3-414, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-414 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (2) and (4) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Burden of Proof.

Where special defense of holder's default in presenting check was relied on, burden was on drawer to prove fact and extent of his loss. Sims v. Hunter, 44 Idaho 505, 258 P. 550 (1927).

Claim Independent of Criminal Charges.

Debtor was convicted of passing bad checks. The state criminal court placed debtor on probation and ordered that he pay the other party to the transaction restitution. Several months later debtor and his wife filed for Chapter 7 bankruptcy relief. Under applicable state law, the other party held a claim against debtor based on the dishonor of the checks independent from any obligation created via the criminal prosecution. Accordingly, the court found that the other party was a creditor of debtor at the time of its receipt of the restitution payments, and that those payments were avoidable by the bankruptcy trustee under the Bankruptcy Code. Zimmerman v. Itano Farms, Inc. (In re Currey), 144 Bankr. 490 (Bankr. D. Idaho 1992).

Demand Unnecessary.

Demand of payment from maker of promissory note at maturity was unnecessary in order to bring suit against him. Sabin v. Burke, 4 Idaho 28, 37 P. 352, modified on other grounds, 4 Idaho 189, 38 P. 246 (1894).

Where mortgagors still owed part of principal nearly five years after maturity, no demand was necessary to bind them. Jardine v. Hawkes, 44 Idaho 237, 256 P. 97 (1927).

Failure of Bank.

Presentment of check was not required when drawee bank closed its doors before reasonable time for presentment had expired. Bistline v. Benting, 39 Idaho 534, 228 P. 309 (1924).

Notice to Indorsers.

The holder must have given notice of dishonor to indorsers upon dishonor of a negotiable instrument by nonpayment, in order to have held the indorsers liable. Bradford v. Sturman, 86 Idaho 178, 384 P.2d 64 (1963).

Question for Court.

Where no question of fact was in dispute, determination of what was reasonable diligence in presenting check for payment, in order to discharge drawer, was one of law for the court. Campbell v. Shark, 46 Idaho 278, 267 P. 458 (1928).

Reasonable Time.

As a general rule, question of what was a reasonable length of time in which to present for payment a promissory note which was indorsed after maturity was one of fact, to be determined by circumstances of each particular case. Sheffield v. Cleland, 19 Idaho 612, 115 P. 20 (1911).

Where transaction and bank were in one locality, in absence of clearly excusable circumstances or conditions, five days after delivering constitutes unreasonable time within which to present check for payment or at least to deposit for collection. Campbell v. Shark, 46 Idaho 278, 267 P. 458 (1928).

That a check was received after banking hours, deposited in payee's bank the following day, and that payee's bank could not present it on the following business day because of failure of drawee did not show

negligence in presentment in a reasonable time. Clarke v. Davis, 48 Idaho 214, 281 P. 3 (1929).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 412 et seq.

Official Comment

1. Subsection (a) excludes cashier's checks because the obligation of the issuer of a cashier's check is stated in Section 3-412.

2. Subsection (b) states the obligation of the drawer on an unaccepted draft. It replaces former Section 3-413(2). The requirement under former Article 3 of notice of dishonor or protest has been eliminated. Under revised Article 3, notice of dishonor is necessary only with respect to indorser's liability. The liability of the drawer of an unaccepted draft is treated as a primary liability. Under former Section 3-102(1)(d) the term "secondary party" was used to refer to a drawer or indorser. The quoted term is not used in revised Article 3. The effect of a draft drawn without recourse is stated in subsection (e).

3. Under subsection (c) the drawer is discharged of liability on a draft accepted by a bank regardless of when acceptance was obtained. This changes former Section 3-411(1) which provided that the drawer is discharged only if the holder obtains acceptance. Holders that have a bank obligation do not normally rely on the drawer to guarantee the bank's solvency. A holder can obtain protection against the insolvency of a bank acceptor by a specific guaranty of payment by the drawer or by obtaining an indorsement by the drawer. Section 3-205(d).

4. Subsection (d) states the liability of the drawer if a draft is accepted by a drawee other than a bank and the acceptor dishonors. The drawer of an unaccepted draft is the only party liable on the instrument. The drawee has no liability on the draft. Section 3-408. When the draft is accepted, the obligations change. The drawee, as acceptor, becomes primarily liable and the drawer's liability is that of a person secondarily liable as a guarantor of payment. The drawer's liability is identical to that of an indorser, and subsection (d) states the drawer's liability that way. The drawer is liable to

pay the person entitled to enforce the draft or any indorser that pays pursuant to Section 3-415. The drawer in this case is discharged if notice of dishonor is required by Section 3-503 and is not given in compliance with that section. A drawer that pays has a right of recourse against the acceptor. Section 3-413(a).

5. Subsection (e) does not permit the drawer of a check to avoid liability under subsection (b) by drawing the check without recourse. There is no legitimate purpose served by issuing a check on which nobody is liable. Drawing without recourse is effective to disclaim liability of the drawer if the draft is not a check. Suppose, in a documentary sale, Seller draws a draft on Buyer for the price of goods shipped to Buyer. The draft is payable upon delivery to the drawee of an order bill of lading covering the goods. Seller delivers the draft with the bill of lading to Finance Company that is named as payee of the draft. If Seller draws without recourse Finance Company takes the risk that Buyer will dishonor. If Buyer dishonors, Finance Company has no recourse against Seller but it can obtain reimbursement by selling the goods which it controls through the bill of lading.

6. Subsection (f) is derived from former Section 3-502(1)(b). It is designed to protect the drawer of a check against loss resulting from suspension of payments by the drawee bank when the holder of the check delays collection of the check. For example, X writes a check payable to Y for $1,000. The check is covered by funds in X's account in the drawee bank. Y delays initiation of collection of the check for more than 30 days after the date of the check. The drawee bank suspends payments after the 30-day period and before the check is presented for payment. If the $1,000 of funds in X's account have not been withdrawn, X has a claim for those funds against the drawee bank and, if subsection (e) were not in effect, X would be liable to Y on the check because the check was dishonored. Section 3-502(e). If the suspension of payments by the drawee bank will result in payment to X of less than the full amount of the $1,000 in the account or if there is a significant delay in payment to X, X will suffer a loss which would not have been suffered if Y had promptly initiated collection of the check. In most cases, X will not suffer any loss because of the existence of federal bank deposit insurance that covers accounts up to $100,000. Thus, subsection (e) has relatively little importance. There might be some cases, however, in which the account is not fully insured because it

exceeds \$100,000 or because the account doesn't qualify for deposit insurance. Subsection (f) retains the phrase "deprived of funds maintained with the drawee" appearing in former Section 3-502(1)(b). The quoted phrase applies if the suspension of payments by the drawee prevents the drawer from receiving the benefit of funds which would have paid the check if the holder had been timely in initiating collection. Thus, any significant delay in obtaining full payment of the funds is a deprivation of funds. The drawer can discharge drawer's liability by assigning rights against the drawee with respect to the funds to the holder.

7. The obligation of the drawer under this section is similar to the obligation of the drawer under Article 38 of the Convention on International Bills of Exchange and International Promissory Notes.

§ 28-3-415. Obligation of indorser. — (1) Subject to subsections (2), (3) and (4) of this section and to section 28-3-419(4)[, Idaho Code], if an instrument is dishonored, an indorser is obliged to pay the amount due on the instrument (i) according to the terms of the instrument at the time it was indorsed, or (ii) if the indorser indorsed an incomplete instrument, according to its terms when completed, to the extent stated in sections 28-3-115 and 28-3-407[, Idaho Code]. The obligation of the indorser is owed to a person entitled to enforce the instrument or to a subsequent indorser who paid the instrument under this section.

(2) If an indorsement states that it is made "without recourse" or otherwise disclaims liability of the indorser, the indorser is not liable under subsection (1) of this section to pay the instrument.

(3) If notice of dishonor of an instrument is required by section 28-3-503[, Idaho Code,] and notice of dishonor complying with that section is not given to an indorser, the liability of the indorser under subsection (1) of this section is discharged.

(4) If a draft is accepted by a bank after an indorsement is made, the liability of the indorser under subsection (1) of this section is discharged.

(5) If an indorser of a check is liable under subsection (1) of this section and the check is not presented for payment, or given to a depositary bank for collection, within thirty (30) days after the day the indorsement was made, the liability of the indorser under subsection (1) of this section is discharged.

History.

I.C., § 28-3-415, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-415 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (1) and (3) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Demand Unnecessary.

Demand of payment from maker of promissory note at maturity was unnecessary in order to bring suit against him. Sabin v. Burke, 4 Idaho 28, 37 P. 352, modified on other grounds, 4 Idaho 189, 38 P. 246 (1894).

Where mortgagors still owed part of principal nearly five years after maturity, no demand was necessary to bind them. Jardine v. Hawkes, 44 Idaho 237, 256 P. 97 (1927).

Failure of Bank.

Presentment of check was not required when drawee bank closed its doors before reasonable time for presentment had expired. Bistline v. Benting, 39 Idaho 534, 228 P. 309 (1924).

Liability of Indorser.

Undertaking of indorser was conditional; that is, his promise was that he would pay provided payment shall first have been properly demanded of maker and due notice of maker's neglect or refusal shall have been given. Ankeny & Son v. Henry, 1 Idaho 229 (1869).

Warranty of indorser, under former law, runs only to holder in due course. Moody v. Morris-Roberts Co., 38 Idaho 414, 226 P. 278 (1923).

Beneficiary was not subject to equitable subrogation, because the beneficiary only signed a relative's promissory note as an accommodation

party; the evidence showed that the beneficiary did not receive any consideration for signing the note. Rowan v. Riley, 139 Idaho 49, 72 P.3d 889 (2003).

Notice to Indorser.

The holder must have given notice of dishonor to the indorser upon dishonor of a negotiable instrument by nonpayment, in order to have held the indorser liable. Bradford v. Sturman, 86 Idaho 178, 384 P.2d 64 (1963).

"Without Recourse."

An indorsement without recourse could not be regarded as evidence against an indorsee's holding in good faith. Continental Nat'l Bank v. Cole, 51 Idaho 140, 3 P.2d 1103 (1931).

An indorsement without recourse did not operate as a notice of defenses. Continental Nat'l Bank v. Cole, 51 Idaho 140, 3 P.2d 1103 (1931).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 420 et seq.

C.J.S. — 10 C.J.S., Bills and Notes, § 170 et seq.

Official Comment

1. Subsections (a) and (b) restate the substance of former Section 3-414(1). Subsection (2) of former Section 3-414 has been dropped because it is superfluous. Although notice of dishonor is not mentioned in subsection (a), it must be given in some cases to charge an indorser. It is covered in subsection (c). Regulation CC § 229.35(b) provides that a bank handling a check for collection or return is liable to a bank that subsequently handles the check to the extent the latter bank does not receive payment for the check. This liability applies whether or not the bank incurring the liability indorsed the check.

2. Section 3-503 states when notice of dishonor is required and how it must be given. If required notice of dishonor is not given in compliance with Section 3-503, subsection (c) of Section 3-415 states that the effect is to discharge the indorser's obligation.

3. Subsection (d) is similar in effect to Section 3-414(c) if the draft is accepted by a bank after the indorsement is made. See Comment 3 to Section 3-414. If a draft is accepted by a bank before the indorsement is made, the indorser incurs the obligation stated in subsection (a).

4. Subsection (e) modifies former Sections 3-503(2)(b) and 3-502(1)(a) by stating a 30-day rather than a seven-day period, and stating it as an absolute rather than a presumptive period.

5. As stated in subsection (a), the obligation of an indorser to pay the amount due on the instrument is generally owed not only to a person entitled to enforce the instrument but also to a subsequent indorser who paid the instrument. But if the prior indorser and the subsequent indorser are both anomalous indorsers, this rule does not apply. In that case, Section 3-116 applies. Under Section 3-116(a), the anomalous indorsers are jointly and severally liable and if either pays the instrument the indorser who pays has a right of contribution against the other. Section 3-116(b). The right to contribution in Section 3-116(b) is subject to "agreement of the affected parties." Suppose the subsequent indorser can prove an agreement with the prior indorser under which the prior indorser agreed to treat the subsequent indorser as a guarantor of the obligation of the prior indorser. Rights of the two indorsers between themselves would be governed by the agreement. Under suretyship law, the subsequent indorser under such an agreement is referred to as a sub-surety. Under the agreement, if the subsequent indorser pays the instrument there is a right to reimbursement from the prior indorser; if the prior indorser pays the instrument, there is no right of recourse against the subsequent indorser. See PEB Commentary No. 11, dated February 10, 1994.

6. The rule of this section is similar to the rule of Article 44 of the Convention on International Bills of Exchange and International Promissory Notes.

§ 28-3-416. Transfer warranties. — (1) A person who transfers an instrument for consideration warrants to the transferee and, if the transfer is by indorsement, to any subsequent transferee that:

(a) The warrantor is a person entitled to enforce the instrument;

(b) All signatures on the instrument are authentic and authorized;

(c) The instrument has not been altered;

(d) The instrument is not subject to a defense or claim in recoupment of any party which can be asserted against the warrantor;

(e) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and

(f) If the instrument is a demand draft, creation of the instrument according to the terms on its face was authorized by the person identified as drawer.

(2) A person to whom the warranties under subsection (1) of this section are made and who took the instrument in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the instrument plus expenses and loss of interest incurred as a result of the breach.

(3) The warranties stated in subsection (1) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty (30) days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (2) of this section is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(4) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(5) If the warranty in subsection (1)(f) of this section is not given by a transferor under applicable conflict of law rules, then the warranty is not

given to that transferor when that transferor is a transferee.

History.

I.C., § 28-3-416, as added by 1993, ch. 288, § 2, p. 1019; am. 2002, ch. 121, § 3, p. 338.

STATUTORY NOTES

Prior Laws.

Former § 28-3-416 was repealed. See Prior Laws, § 28-3-101.

Official Comment

1. Subsection (a) is taken from subsection (2) of former Section 3-417. Subsections (3) and (4) of former Section 3-417 are deleted. Warranties under subsection (a) in favor of the immediate transferee apply to all persons who transfer an instrument for consideration whether or not the transfer is accompanied by indorsement. Any consideration sufficient to support a simple contract will support those warranties. If there is an indorsement the warranty runs with the instrument and the remote holder may sue the indorser-warrantor directly and thus avoid a multiplicity of suits.

2. Since the purpose of transfer (Section 3-203(a)) is to give the transferee the right to enforce the instrument, subsection (a)(1) is a warranty that the transferor is a person entitled to enforce the instrument (Section 3-301). Under Section 3-203(b) transfer gives the transferee any right of the transferor to enforce the instrument. Subsection (a)(1) is in effect a warranty that there are no unauthorized or missing indorsements that prevent the transferor from making the transferee a person entitled to enforce the instrument.

3. The rationale of subsection (a)(4) is that the transferee does not undertake to buy an instrument that is not enforceable in whole or in part, unless there is a contrary agreement. Even if the transferee takes as a holder in due course who takes free of the defense or claim in recoupment, the warranty gives the transferee the option of proceeding against the transferor rather than litigating with the obligor on the instrument the issue of the

holder-in-due-course status of the transferee. Subsection (3) of former Section 3-417 which limits this warranty is deleted. The rationale is that while the purpose of a "no recourse" indorsement is to avoid a guaranty of payment, the indorsement does not clearly indicate an intent to disclaim warranties.

4. Under subsection (a)(5) the transferor does not warrant against difficulties of collection, impairment of the credit of the obligor or even insolvency. The transferee is expected to determine such questions before taking the obligation. If insolvency proceedings as defined in Section 1-201(22) have been instituted against the party who is expected to pay and the transferor knows it, the concealment of that fact amounts to a fraud upon the transferee, and the warranty against knowledge of such proceedings is provided accordingly.

5. Transfer warranties may be disclaimed with respect to any instrument except a check. Between the immediate parties disclaimer may be made by agreement. In the case of an indorser, disclaimer of transferor's liability, to be effective, must appear in the indorsement with words such as "without warranties" or some other specific reference to warranties. But in the case of a check, subsection (c) of Section 3-416 provides that transfer warranties cannot be disclaimed at all. In the check collection process the banking system relies on these warranties.

6. Subsection (b) states the measure of damages for breach of warranty. There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the phrase "expenses *** incurred as a result of the breach." The intention is to leave to other state law the issue as to when attorney's fees are recoverable.

7. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (d) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

8. Subsection (a)(6) [text differs from (1)(f) adopted in 2002 in Idaho] is based on a number of nonuniform amendments designed to address concerns about certain kinds of check fraud. The provision implements a limited rejection of *Price v. Neal*, 97 Eng. Rep. 871 (K.B. 1762), so that in

certain circumstances (those involving remotely-created consumer items) the payor bank can use a warranty claim to absolve itself of responsibility for honoring an unauthorized item. The provision rests on the premise that monitoring by depositary banks can control this type of fraud more effectively than any practices readily available to payor banks. The provision expressly includes both the case in which the consumer does not authorize the item at all and also the case in which the consumer authorizes the item but in an amount different from the amount in which the item is drawn. Similar provisions appear in Sections 3-417, 4-207, and 4-208.

The provision supplements applicable federal law, which requires telemarketers who submit instruments for payment to obtain the customer's "express verifiable authorization," which may be either in writing or tape recorded and must be made available upon request to the customer's bank. Federal Trade Commission's Telemarketing Sales Rule, 16 C.F.R. § 310.3(a)(3), implementing the Telemarketing and Consumer Fraud and Abuse Prevention Act, 15 U.S.C. §§ 6101-6108. Some states also have consumer-protection laws governing authorization of instruments in telemarketing transactions. See, e.g., 9 Vt. Stat. Ann. § 2464.

9. Article 45 of the Convention on International Bills of Exchange and International Promissory Notes includes warranties that are similar (except for the warranty in subsection (a)(6)).

§ 28-3-417. Presentment warranties. — (1) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee making payment or accepting the draft in good faith that:

(a) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(b) The draft has not been altered;

(c) The warrantor has no knowledge that the signature of the drawer of the draft is unauthorized; and

(d) If the draft is a demand draft, creation of the demand draft according to the terms on its face was authorized by the person identified as drawer.

(2) A drawee making payment may recover from any warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft, breach of warranty is a defense to the obligation of the acceptor. If the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from any warrantor for breach of warranty the amounts stated in this subsection.

(3) If a drawee asserts a claim for breach of warranty under subsection (1) of this section, based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under section 28-3-404 or 28-3-405[, Idaho Code,] or the drawer is precluded under section 28-3-406 or 28-4-406[, Idaho

Code,] from asserting against the drawee the unauthorized indorsement or alteration.

(4) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other instrument is presented for payment to a party obliged to pay the instrument, and (iii) payment is received, the following rules apply:

(a) The person obtaining payment and a prior transferor of the instrument warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the instrument, a person entitled to enforce the instrument or authorized to obtain payment on behalf of a person entitled to enforce the instrument.

(b) The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(5) The warranties stated in subsections (1) and (4) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty (30) days after the claimant has reason to know of the breach and the identity of the warrantor, the liability of the warrantor under subsection (2) or (4) of this section is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(6) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(7) A demand draft is a check, as provided in section 28-3-104[, Idaho Code].

(8) If the warranty in subsection (1)(d) of this section is not given by a transferor under applicable conflict of law rules, the warranty is not given to that transferor when the transferor is a transferee.

History.

I.C., § 28-3-417, as added by 1993, ch. 288, § 2, p. 1019; am. 2002, ch. 121, § 4, p. 338.

STATUTORY NOTES

Prior Laws.

Former § 28-3-417 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (3) and (7) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Beneficiaries of Warranty.

Warranty of indorser, under former law, ran only to holder in due course. Moody v. Morris-Roberts Co., 38 Idaho 414, 226 P. 278 (1923).

Official Comment

1. This section replaces subsection (1) of former Section 3-417. The former provision was difficult to understand because it purported to state in one subsection all warranties given to any person paying any instrument. The result was a provision replete with exceptions that could not be readily understood except after close scrutiny of the language. In revised Section 3-417, presentment warranties made to drawees of uncertified checks and other unaccepted drafts are stated in subsection (a). All other presentment warranties are stated in subsection (d).

2. Subsection (a) states three warranties. Subsection (a)(1) in effect is a warranty that there are no unauthorized or missing indorsements. "Person entitled to enforce" is defined in Section 3-301. Subsection (a)(2) is a warranty that there is no alteration. Subsection (a)(3) is a warranty of no knowledge that there is a forged drawer's signature. Subsection (a) states that the warranties are made to the drawee and subsections (b) and (c) identify the drawee as the person entitled to recover for breach of warranty. There is no warranty made to the drawer under subsection (a) when presentment is made to the drawee. Warranty to the drawer is governed by subsection (d) and that applies only when presentment for payment is made to the drawer with respect to a dishonored draft. In *Sun 'N Sand, Inc. v. United California Bank,* 582 P.2d 920 (Cal. 1978), the court held that under

former Section 3-417(1) a warranty was made to the drawer of a check when the check was presented to the drawee for payment. The result in that case is rejected.

3. Subsection (a)(1) retains the rule that the drawee does not admit the authenticity of indorsements and subsection (a)(3) retains the rule of *Price v. Neal,* 3 Burr. 1354 (1762), that the drawee takes the risk that the drawer's signature is unauthorized unless the person presenting the draft has knowledge that the drawer's signature is unauthorized. Under subsection (a)(3) the warranty of no knowledge that the drawer's signature is unauthorized is also given by prior transferors of the draft.

4. Subsection (d) applies to presentment for payment in all cases not covered by subsection (a). It applies to presentment of notes and accepted drafts to any party obliged to pay the instrument, including an indorser, and to presentment of dishonored drafts if made to the drawer or an indorser. In cases covered by subsection (d), there is only one warranty and it is the same as that stated in subsection (a)(1). There are no warranties comparable to subsections (a)(2) and (a)(3) because they are appropriate only in the case of presentment to the drawee of an unaccepted draft. With respect to presentment of an accepted draft to the acceptor, there is no warranty with respect to alteration or knowledge that the signature of the drawer is unauthorized. Those warranties were made to the drawee when the draft was presented for acceptance (Section 3-417(a)(2) and (3)) and breach of that warranty is a defense to the obligation of the drawee as acceptor to pay the draft. If the drawee pays the accepted draft the drawee may recover the payment from any warrantor who was in breach of warranty when the draft was accepted. Section 3-417(b). Thus, there is no necessity for these warranties to be repeated when the accepted draft is presented for payment. Former Section 3-417(1)(b)(iii) and (c)(iii) are not included in revised Section 3-417 because they are unnecessary. Former Section 3-417(1)(c)(iv) is not included because it is also unnecessary. The acceptor should know what the terms of the draft were at the time acceptance was made.

If presentment is made to the drawer or maker, there is no necessity for a warranty concerning the signature of that person or with respect to alteration. If presentment is made to an indorser, the indorser had itself warranted authenticity of signatures and that the instrument was not altered. Section 3-416(a)(2) and (3).

5. The measure of damages for breach of warranty under subsection (a) is stated in subsection (b). There is no express provision for attorney's fees, but attorney's fees are not meant to be necessarily excluded. They could be granted because they fit within the language "expenses *** resulting from the breach." Subsection (b) provides that the right of the drawee to recover for breach of warranty is not affected by a failure of the drawee to exercise ordinary care in paying the draft. This provision follows the result reached under former Article 3 in *Hartford Accident & Indemnity Co. v. First Pennsylvania Bank,* 859 F.2d 295 (3d Cir. 1988).

6. Subsection (c) applies to checks and other unaccepted drafts. It gives to the warrantor the benefit of rights that the drawee has against the drawer under Section 3-404, 3-405, 3-406, or 4-406. If the drawer's conduct contributed to a loss from forgery or alteration, the drawee should not be allowed to shift the loss from the drawer to the warrantor.

7. The first sentence of subsection (e) recognizes that checks are normally paid by automated means and that payor banks rely on warranties in making payment. Thus, it is not appropriate to allow disclaimer or warranties appearing on checks that normally will not be examined by the payor bank. The second sentence requires a breach of warranty claim to be asserted within 30 days after the drawee learns of the breach and the identity of the warrantor.

8. Since the traditional term "cause of action" may have been replaced in some states by "claim for relief" or some equivalent term, the words "cause of action" in subsection (f) have been bracketed to indicate that the words may be replaced by an appropriate substitute to conform to local practice.

9. For discussion of subsection (a)(4), see Comment 8 to Section 3-416.

§ 28-3-418. Payment or acceptance by mistake. — (1) Except as provided in subsection (3) of this section, if the drawee of a draft pays or accepts the draft and the drawee acted on the mistaken belief that (i) payment of the draft had not been stopped pursuant to section 28-4-403[, Idaho Code], or (ii) the signature of the drawer of the draft was authorized, the drawee may recover the amount of the draft from the person to whom or for whose benefit payment was made or, in the case of acceptance, may revoke the acceptance. Rights of the drawee under this subsection are not affected by failure of the drawee to exercise ordinary care in paying or accepting the draft.

(2) Except as provided in subsection (3) of this section, if an instrument has been paid or accepted by mistake and the case is not covered by subsection (1) of this section, the person paying or accepting may, to the extent permitted by the law governing mistake and restitution, (i) recover the payment from the person to whom or for whose benefit payment was made or (ii) in the case of acceptance, may revoke the acceptance.

(3) The remedies provided in subsection (1) or (2) of this section may not be asserted against a person who took the instrument in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. This subsection does not limit remedies provided in section 28-3-417 or 28-4-407[, Idaho Code].

(4) Notwithstanding section 28-4-215[, Idaho Code,] if an instrument is paid or accepted by mistake and the payor or acceptor recovers payment or revokes acceptance under subsection (1) or (2) of this section, the instrument is deemed not to have been paid or accepted and is treated as dishonored, and the person from whom payment is recovered has rights as a person entitled to enforce the dishonored instrument.

History.

I.C., § 28-3-418, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-418 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (1), (3), and (4) were added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 371 et seq.

CASE NOTES

Decisions Under Prior Law

Trade Acceptance.

A trade acceptance drawn by the seller of goods and accepted by the buyer, payable to the order of a payee designated by the drawer, was a negotiable instrument under which acceptor, by his acceptance, became primarily liable for payment. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

Official Comment

1. This section covers payment or acceptance by mistake and replaces former Section 3-418. Under former Article 3, the remedy of a drawee that paid or accepted a draft by mistake was based on the law of mistake and restitution, but that remedy was not specifically stated. It was provided by Section 1-103. Former Section 3-418 was simply a limitation on the unstated remedy under the law of mistake and restitution. Under revised Article 3, Section 3-418 specifically states the right of restitution in subsections (a) and (b). Subsection (a) allows restitution in the two most common cases in which the problem is presented: payment or acceptance of forged checks and checks on which the drawer has stopped payment. If the drawee acted under a mistaken belief that the check was not forged or had not been stopped, the drawee is entitled to recover the funds paid or to revoke the acceptance whether or not the drawee acted negligently. But in each case, by virtue of subsection (c), the drawee loses the remedy if the person receiving payment or acceptance was a person who took the check

in good faith and for value or who in good faith changed position in reliance on the payment or acceptance. Subsections (a) and (c) are consistent with former Section 3-418 and the rule of *Price v. Neal*. The result in the two cases covered by subsection (a) is that the drawee in most cases will not have a remedy against the person paid because there is usually a person who took the check in good faith and for value or who in good faith changed position in reliance on the payment or acceptance.

2. If a check has been paid by mistake and the payee receiving payment did not give value for the check or did not change position in reliance on the payment, the drawee bank is entitled to recover the amount of the check under subsection (a) regardless of how the check was paid. The drawee bank normally pays a check by a credit to an account of the collecting bank that presents the check for payment. The payee of the check normally receives the payment by a credit to the payee's account in the depositary bank. But in some cases the payee of the check may have received payment directly from the drawee bank by presenting the check for payment over the counter. In those cases the payee is entitled to receive cash, but the payee may prefer another form of payment such as a cashier's check or teller's check issued by the drawee bank. Suppose Seller contracted to sell goods to Buyer. The contract provided for immediate payment by Buyer and delivery of the goods 20 days after payment. Buyer paid by mailing a check for $10,000 drawn on Bank payable to Seller. The next day Buyer gave a stop payment order to Bank with respect to the check Buyer had mailed to Seller. A few days later Seller presented Buyer's check to Bank for payment over the counter and requested a cashier's check as payment. Bank issued and delivered a cashier's check for $10,000 payable to Seller. The teller failed to discover Buyer's stop order. The next day Bank discovered the mistake and immediately advised Seller of the facts. Seller refused to return the cashier's check and did not deliver any goods to Buyer.

Under Section 4-215, Buyer's check was paid by Bank at the time it delivered its cashier's check to Seller. See Comment 3 to Section 4-215. Bank is obliged to pay the cashier's check and has no defense to that obligation. The cashier's check was issued for consideration because it was issued in payment of Buyer's check. Although Bank has no defense on its cashier's check it may have a right to recover $10,000, the amount of Buyer's check, from Seller under Section 3-418(a). Bank paid Buyer's

check by mistake. Seller did not give value for Buyer's check because the promise to deliver goods to Buyer was never performed. Section 3-303(a)(1). And, on these facts, Seller did not change position in reliance on the payment of Buyer's check. Thus, the first sentence of Section 3-418(c) does not apply and Seller is obliged to return $10,000 to Bank. Bank is obliged to pay the cashier's check but it has a counterclaim against Seller based on its rights under Section 3-418(a). This claim can be asserted against Seller, but it cannot be asserted against some other person with rights of a holder in due course of the cashier's check. A person without rights of a holder in due course of the cashier's check would take subject to Bank's claim against Seller because it is a claim in recoupment. Section 3-305(a)(3).

If Bank recovers from Seller under Section 3-418(a), the payment of Buyer's check is treated as unpaid and dishonored. Section 3-418(d). One consequence is that Seller may enforce Buyer's obligation as drawer to pay the check. Section 3-414. Another consequence is that Seller's rights against Buyer on the contract of sale are also preserved. Under Section 3-310(b) Buyer's obligation to pay for the goods was suspended when Seller took Buyer's check and remains suspended until the check is either dishonored or paid. Under Section 3-310(b)(1) the obligation is discharged when the check is paid. Since Section 3-418(d) treats Buyer's check as unpaid and dishonored, Buyer's obligation is not discharged and suspension of the obligation terminates. Under Section 3-310(b)(3), Seller may enforce either the contract of sale or the check subject to defenses and claims of Buyer.

If Seller had released the goods to Buyer before learning about the stop order, Bank would have no recovery against Seller under Section 3-418(a) because Seller in that case gave value for Buyer's check. Section 3-418(c). In this case, Bank's sole remedy is under Section 4-407 by subrogation.

3. Subsection (b) covers cases of payment or acceptance by mistake that are not covered by subsection (a). It directs courts to deal with those cases under the law governing mistake and restitution. Perhaps the most important class of cases that falls under subsection (b), because it is not covered by subsection (a), is that of payment by the drawee bank of a check with respect to which the bank has no duty to the drawer to pay either because the drawer has no account with the bank or because available funds in the drawer's account are not sufficient to cover the amount of the check.

With respect to such a case, under Restatement of Restitution § 29, if the bank paid because of a mistaken belief that there were available funds in the drawer's account sufficient to cover the amount of the check, the bank is entitled to restitution. But § 29 is subject to Restatement of Restitution § 33 which denies restitution if the holder of the check receiving payment paid value in good faith for the check and had no reason to know that the check was paid by mistake when payment was received.

The result in some cases is clear. For example, suppose Father gives Daughter a check for $10,000 as a birthday gift. The check is drawn on Bank in which both Father and Daughter have accounts. Daughter deposits the check in her account in Bank. An employee of Bank, acting under the belief that there were available funds in Father's account to cover the check, caused Daughter's account to be credited for $10,000. In fact, Father's account was overdrawn and Father did not have overdraft privileges. Since Daughter received the check gratuitously there is clear unjust enrichment if she is allowed to keep the $10,000 and Bank is unable to obtain reimbursement from Father. Thus, Bank should be permitted to reverse the credit to Daughter's account. But this case is not typical. In most cases the remedy of restitution will not be available because the person receiving payment of the check will have given value for it in good faith.

In some cases, however, it may not be clear whether a drawee bank should have a right of restitution. For example, a check-kiting scheme may involve a large number of checks drawn on a number of different banks in which the drawer's credit balances are based on uncollected funds represented by fraudulently drawn checks. No attempt is made in Section 3-418 to state rules for determining the conflicting claims of the various banks that may be victimized by such a scheme. Rather, such cases are better resolved on the basis of general principles of law and the particular facts presented in the litigation.

4. The right of the drawee to recover a payment or to revoke an acceptance under Section 3-418 is not affected by the rules under Article 4 that determine when an item is paid. Even though a payor bank may have paid an item under Section 4-215, it may have a right to recover the payment under Section 3-418. *National Savings & Trust Co. v. Park Corp.*, 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), correctly

states the law on the issue under former Article 3. Revised Article 3 does not change the previous law.

§ 28-3-419. Instruments signed for accommodation. — (1) If an instrument is issued for value given for the benefit of a party to the instrument ("accommodated party") and another party to the instrument ("accommodation party") signs the instrument for the purpose of incurring liability on the instrument without being a direct beneficiary of the value given for the instrument, the instrument is signed by the accommodation party "for accommodation."

(2) An accommodation party may sign the instrument as maker, drawer, acceptor, or indorser and, subject to subsection (4) of this section, is obliged to pay the instrument in the capacity in which the accommodation party signs. The obligation of an accommodation party may be enforced notwithstanding any statute of frauds and whether or not the accommodation party receives consideration for the accommodation.

(3) A person signing an instrument is presumed to be an accommodation party and there is notice that the instrument is signed for accommodation if the signature is an anomalous indorsement or is accompanied by words indicating that the signer is acting as surety or guarantor with respect to the obligation of another party to the instrument. Except as provided in section 28-3-605[, Idaho Code], the obligation of an accommodation party to pay the instrument is not affected by the fact that the person enforcing the obligation had notice when the instrument was taken by that person that the accommodation party signed the instrument for accommodation.

(4) If the signature of a party to an instrument is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the obligation of another party to the instrument, the signer is obliged to pay the amount due on the instrument to a person entitled to enforce the instrument only if (i) execution of judgment against the other party has been returned unsatisfied, (ii) the other party is insolvent or in an insolvency proceeding, (iii) the other party cannot be served with process, or (iv) it is otherwise apparent that payment cannot be obtained from the other party.

(5) An accommodation party who pays the instrument is entitled to reimbursement from the accommodated party and is entitled to enforce the

instrument against the accommodated party. An accommodated party who pays the instrument has no right of recourse against, and is not entitled to contribution from, an accommodation party.

History.

I.C., § 28-3-419, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-419 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in the second sentence in subsection (3) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Decisions Under Prior Law

Accommodation Maker.

That accommodation maker received no consideration for note was no defense in action for its payment. Central Bank v. Perkins, 43 Idaho 310, 251 P. 627 (1926).

A maker becomes an accommodation maker if he or she signed a note to accommodate the primary obligor and is in the position of a surety, having a right of recourse against the maker. First Nat'l Bank v. Burgess, 118 Idaho 627, 798 P.2d 472 (Ct. App. 1990).

Bank As Payee.

Fact that negotiable instrument was made payable to and delivered to bank did not make bank accommodated party. Central Bank v. Perkins, 43 Idaho 310, 251 P. 627 (1926).

Guarantor.

Common law rule that "satisfaction of the principal debt or a release of the principal debtor discharges the guarantor" will no longer apply to a guarantor who is deemed "an accommodation party" under former similar section and former law regarding cancellation and renunciation. Ponderosa Paint Mfg., Inc. v. Yack, 125 Idaho 310, 870 P.2d 663 (Ct. App. 1994).

Instrument Payable to Bearer.

Where it was admitted by all parties, that there was never any intention of delivering the note or making payment to, or securing the loan from, the payee named in the note, the note was payable to bearer. Ritter v. Moore, 64 Idaho 144, 128 P.2d 639 (1942).

Nonliability for Costs.

Former law provided for collection costs and attorney fees to be assessed only against the drawer of an instrument, not against accommodation parties. Airstream, Inc. v. CIT Fin. Servs., Inc., 111 Idaho 307, 723 P.2d 851 (1986).

Parties in Interest.

Former statutes requiring that all actions be prosecuted in the name of the real party in interest had been modified, as to negotiable instruments, by the uniform negotiable instruments act, allowing anyone in possession of a

negotiable instrument to maintain an action thereon. Ritter v. Moore, 64 Idaho 144, 128 P.2d 639 (1942).

Reliance on Agent's Statement.

Signer of note was entitled to rely on statements of agent of payee inducing signature and was not required to investigate to ascertain whether he was being deceived. Intermountain Ass'n of Credit Men v. Pierce, 43 Idaho 279, 251 P. 615 (1926).

Signature For Corporation.

Mortgagor could not make use of the impairment of collateral defense where mortgagor was the only party who signed promissory notes as obligor, notwithstanding his claim that he signed the notes as an accommodation to his corporation; no other party signed the notes as an obligor and the name of the corporation did not appear on the face of the notes. First Nat'l Bank v. Burgess, 118 Idaho 627, 798 P.2d 472 (Ct. App. 1990).

Signer's Intent.

The question as to whether a party was an accommodation party depended on the signer's purpose in signing; the question of purpose or intent was a factual question to be resolved by the trier of fact. Airstream, Inc. v. CIT Fin. Servs., Inc., 111 Idaho 307, 723 P.2d 851 (1986).

Whether a party is an accommodation maker depends on the signer's purpose in signing the instrument. Kaufman v. Fairchild, 119 Idaho 859, 810 P.2d 1145 (Ct. App. 1991).

Signing in Blank.

Where party placed his name in blank on back of note after delivery and before maturity, he was indorser; and fact that he signed after delivery to payee did not affect his legal status. Thomas v. Hoebel, 46 Idaho 744, 271 P. 931 (1928).

Subrogation.

The district court properly found guarantor who cosigned for brother's loan to be subrogated to the rights of lending bank, where sufficient facts were alleged in complaint to give rise to the right, where guarantor brother

did not bring “unclean hands” to the action, and where guarantor brother did not have “volunteer” status with regard to the cosigning. Hoopes v. Hoopes, 124 Idaho 518, 861 P.2d 88 (Ct. App. 1993).

RESEARCH REFERENCES

ALR. — Who is accommodation party under Uniform Commercial Code § 3-415. 90 A.L.R.3d 342.

Official Comment

1. Section 3-419 replaces former Sections 3-415 and 3-416. An accommodation party is a person who signs an instrument to benefit the accommodated party either by signing at the time value is obtained by the accommodated party or later, and who is not a direct beneficiary of the value obtained. An accommodation party will usually be a co-maker or anomalous indorser. Subsection (a) distinguishes between direct and indirect benefit. For example, if X cosigns a note of Corporation that is given for a loan to Corporation, X is an accommodation party if no part of the loan was paid to X or for X’s direct benefit. This is true even though X may receive indirect benefit from the loan because X is employed by Corporation or is a stockholder of Corporation, or even if X is the sole stockholder so long as Corporation and X are recognized as separate entities.

2. It does not matter whether an accommodation party signs gratuitously either at the time the instrument is issued or after the instrument is in the possession of a holder. Subsection (b) of Section 3-419 takes the view stated in Comment 3 to former Section 3-415 that there need be no consideration running to the accommodation party: “The obligation of the accommodation party is supported by any consideration for which the instrument is taken before it is due. Subsection (2) is intended to change occasional decisions holding that there is no sufficient consideration where an accommodation party signs a note after it is in the hands of a holder who has given value. The [accommodation] party is liable to the holder in such a case even though there is no extension of time or other concession.”

3. As stated in Comment 1, whether a person is an accommodation party is a question of fact. But it is almost always the case that a co-maker who

signs with words of guaranty after the signature is an accommodation party. The same is true of an anomalous indorser. In either case a person taking the instrument is put on notice of the accommodation status of the co-maker or indorser. This is relevant to Section 3-605(h). But, under subsection (c), signing with words of guaranty or as an anomalous indorser also creates a presumption that the signer is an accommodation party. A party challenging accommodation party status would have to rebut this presumption by producing evidence that the signer was in fact a direct beneficiary of the value given for the instrument.

An accommodation party is always a surety. A surety who is not a party to the instrument, however, is not an accommodation party. For example, if M issues a note payable to the order of P, and S signs a separate contract in which S agrees to pay P the amount of the instrument if it is dishonored, S is a surety but is not an accommodation party. In such a case, S's rights and duties are determined under the general law of suretyship. In unusual cases two parties to an instrument may have a surety relationship that is not governed by Article 3 because the requirements of Section 3-419(a) are not met. In those cases the general law of suretyship applies to the relationship. See PEB Commentary No. 11, dated February 10, 1994.

4. Subsection (b) states that an accommodation party is liable on the instrument in the capacity in which the party signed the instrument. In most cases that capacity will be either that of a maker or indorser of a note. But subsection (d) provides a limitation on subsection (b). If the signature of the accommodation party is accompanied by words indicating unambiguously that the party is guaranteeing collection rather than payment of the instrument, liability is limited to that stated in subsection (d), which is based on former Section 3-416(2).

Former Article 3 was confusing because the obligation of a guarantor was covered both in Section 3-415 and in Section 3-416. The latter section suggested that a signature accompanied by words of guaranty created an obligation distinct from that of an accommodation party. Revised Article 3 eliminates that confusion by stating in Section 3-419 the obligation of a person who uses words of guaranty. Portions of former Section 3-416 are preserved. Former Section 3-416(2) is reflected in Section 3-419(d) and former Section 3-416(4) if reflected in Section 3-419(c). Words added to an anomalous indorsement indicating that payment of the instrument is

guaranteed by the indorser do not change the liability of the indorser as stated in Section 3-415. This is a change from former Section 3-416(5). See PEB Commentary No. 11, supra.

5. Subsection (f) [(e)] like former Section 3-415(5), provides that an accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party. Since the accommodation party that pays the instrument is entitled to enforce the instrument against the accommodated party, the accommodation party also obtains rights to any security interest or other collateral that secures payment of the instrument. Subsection (f) [(e)] also provides that an accommodation party that pays the instrument is entitled to reimbursement from the accommodated party. See PEB Commentary No. 11, supra.

6. In occasional cases, the accommodation party might pay the instrument even though the accommodated party had a defense to its obligation that was available to the accommodation party under Section 3-305(d). In such cases, the accommodation party's right to reimbursement may conflict with the accommodated party's right to raise its defense. For example, suppose the accommodation party pays the instrument without being aware of the defense. In that case the accommodation party should be entitled to reimbursement. Suppose the accommodation party paid the instrument with knowledge of the defense. In that case, to the extent of the defense, reimbursement ordinarily would not be justified, but under some circumstances reimbursement may be justified depending upon the facts of the case. The resolution of this conflict is left to the general law of suretyship. Section 1-103. See PEB Commentary No. 11, supra.

7. Section 3-419, along with Section 3-116(a) and (b), Section 3-305(d) and Section 3-605, provides rules governing the rights of accommodation parties. In addition, except to the extent that it is displaced by provisions of this Article, the general law of suretyship also applies to the rights of accommodation parties. Section 1-103. See PEB Commentary No. 11, supra.

§ 28-3-420. Conversion of instrument. — (1) The law applicable to conversion of personal property applies to instruments. An instrument is also converted if it is taken by transfer, other than a negotiation, from a person not entitled to enforce the instrument or a bank makes or obtains payment with respect to the instrument for a person not entitled to enforce the instrument or receive payment. An action for conversion of an instrument may not be brought by (i) the issuer or acceptor of the instrument or (ii) a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a copayee.

(2) In an action under subsection (1) of this section, the measure of liability is presumed to be the amount payable on the instrument, but recovery may not exceed the amount of the plaintiff's interest in the instrument.

(3) A representative, other than a depositary bank, who has in good faith dealt with an instrument or its proceeds on behalf of one who was not the person entitled to enforce the instrument is not liable in conversion to that person beyond the amount of any proceeds that it has not paid out.

History.

I.C., § 28-3-420, as added by 1993, ch. 288, § 2, p. 1019.

CASE NOTES

Decisions Under Prior Law

Effect of acceptance.

Retention by bank.

Effect of Acceptance.

Acceptance bound the drawee although he was not indebted to drawer and received no consideration. McLaughlin's Store v. Copeman, 50 Idaho 214, 294 P. 523 (1930).

Retention by Bank.

The mere retention of a check received by a drawee bank by mail for collection and payment for a period in excess of 24 hours did not constitute an acceptance thereof. Fidelity & Deposit Co. v. Idaho Bank & Trust Co., 173 F. Supp. 70 (D. Idaho 1959).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 495 et seq.

ALR. — Reasonable commercial standards defense for banks under UCC § 3-419(3). 93 A.L.R.4th 888.

Payee's and drawer's right of recovery, in conversion under pre-1990 UCC § 3-419, or post-1990 UCC § 3-420 [rev], for money paid on unauthorized indorsement. 91 A.L.R.5th 89.

Drawer's right of recovery against depositary bank that accepts check with missing indorsement or in violation of restrictive covenant. 104 A.L.R.5th 459.

Official Comment

1. Section 3-420 is a modification of former Section 3-419. The first sentence of Section 3-420(a) states a general rule that the law of conversion applicable to personal property also applies to instruments. Paragraphs (a) and (b) of former Section 3-419(1) are deleted as inappropriate in cases of noncash items that may be delivered for acceptance or payment in collection letters that contain varying instructions as to what to do in the event of nonpayment on the day of delivery. It is better to allow such cases to be governed by the general law of conversion that would address the issue of when, under the circumstances prevailing, the presenter's right to possession has been denied. The second sentence of Section 3-420(a) states that an instrument is converted if it is taken by transfer other than a negotiation from a person not entitled to enforce the instrument or taken for collection or payment from a person not entitled to enforce the instrument or receive payment. This covers cases in which a depositary or payor bank takes an instrument bearing a forged indorsement. It also covers cases in which an instrument is payable to two persons and the two persons are not alternative payees, *e.g.* a check payable to John and Jane Doe. Under

Section 3-110(d) the check can be negotiated or enforced only by both persons acting jointly. Thus, neither payee acting without the consent of the other, is a person entitled to enforce the instrument. If John indorses the check and Jane does not, the indorsement is not effective to allow negotiation of the check. If Depositary Bank takes the check for deposit to John's account, Depositary Bank is liable to Jane for conversion of the check if she did not consent to the transaction. John, acting alone, is not the person entitled to enforce the check because John is not the holder of the check. Section 3-110(d) and Comment 4 to Section 3-110. Depositary Bank does not get any greater rights under Section 4-205(1). If it acted for John as its customer, it did not become holder of the check under that provision because John, its customer, was not a holder.

Under former Article 3, the cases were divided on the issue of whether the drawer of a check with a forged indorsement can assert rights against a depositary bank that took the check. The last sentence of Section 3-420(a) resolves the conflict by following the rule stated in *Stone & Webster Engineering Corp. v. First National Bank & Trust Co.*, 184 N.E.2d 358 (Mass. 1962). There is no reason why a drawer should have an action in conversion. The check represents an obligation of the drawer rather than property of the drawer. The drawer has an adequate remedy against the payor bank for recredit of the drawer's account for unauthorized payment of the check.

There was also a split of authority under former Article 3 on the issue of whether a payee who never received the instrument is a proper plaintiff in a conversion action. The typical case was one in which a check was stolen from the drawer or in which the check was mailed to an address different from that of the payee and was stolen after it arrived at that address. The thief forged the indorsement of the payee and obtained payment by depositing the check to an account in a depositary bank. The issue was whether the payee could bring an action in conversion against the depositary bank or the drawee bank. In revised Article 3, under the last sentence of Section 3-420(a), the payee has no conversion action because the check was never delivered to the payee. Until delivery, the payee does not have any interest in the check. The payee never became the holder of the check nor a person entitled to enforce the check. Section 3-301. Nor is the payee injured by the fraud. Normally the drawer of a check intends to

pay an obligation owed to the payee. But if the check is never delivered to the payee, the obligation owed to the payee is not affected. If the check falls into the hands of a thief who obtains payment after forging the signature of the payee as an indorsement, the obligation owed to the payee continues to exist after the thief receives payment. Since the payee's right to enforce the underlying obligation is unaffected by the fraud of the thief, there is no reason to give any additional remedy to the payee. The drawer of the check has no conversion remedy, but the drawee is not entitled to charge the drawer's account when the drawee wrongfully honored the check. The remedy of the drawee is against the depositary bank for breach of warranty under Section 3-417(a)(1) or 4-208(a)(1). The loss will fall on the person who gave value to the thief for the check.

The situation is different if the check is delivered to the payee. If the check is taken for an obligation owed to the payee, the last sentence of Section 3-310(b)(4) provides that the obligation may not be enforced to the extent of the amount of the check. The payee's rights are restricted to enforcement of the payee's rights in the instrument. In this event the payee is injured by the theft and has a cause of action for conversion.

The payee receives delivery when the check comes into the payee's possession, as for example when it is put into the payee's mailbox. Delivery to an agent is delivery to the payee. If a check is payable to more than one payee, delivery to one of the payees is deemed to be delivery to all of the payees. Occasionally, the person asserting a conversion cause of action is an indorsee rather than the original payee. If the check is stolen before the check can be delivered to the indorsee and the indorsee's indorsement is forged, the analysis is similar. For example, a check is payable to the order of A. A indorses it to B and puts it into an envelope addressed to B. The envelope is never delivered to B. Rather, Thief steals the envelope, forges B's indorsement to the check and obtains payment. Because the check was never delivered to B, the indorsee, B has no cause of action for conversion, but A does have such an action. A is the owner of the check. B never obtained rights in the check. If A intended to negotiate the check to B in payment of an obligation, that obligation was not affected by the conduct of Thief. B can enforce that obligation. Thief stole A's property not B's.

2. Subsection (2) of former Section 3-419 is amended because it is not clear why the former law distinguished between the liability of the drawee

and that of other converters. Why should there be a conclusive presumption that the liability is face amount if a drawee refuses to pay or return an instrument or makes payment on a forged indorsement, while the liability of a maker who does the same thing is only presumed to be the face amount? Moreover, it was not clear under former Section 3-419(2) what face amount meant. If a note for $10,000 is payable in a year at 10% interest, it is common to refer to $10,000 as the face amount, but if the note is converted the loss to the owner also includes the loss of interest. In revised Article 3, Section 3-420(b), by referring to "amount payable on the instrument," allows the full amount due under the instrument to be recovered.

The "but" clause in subsection (b) addresses the problem of conversion actions in multiple payee checks. Section 3-110(d) states that an instrument cannot be enforced unless all payees join in the action. But an action for conversion might be brought by a payee having no interest or a limited interest in the proceeds of the check. This clause prevents such a plaintiff from receiving a windfall. An example is a check payable to a building contractor and a supplier of building material. The check is not payable to the payees alternatively. Section 3-110(d). The check is delivered to the contractor by the owner of the building. Suppose the contractor forges supplier's signature as an indorsement of the check and receives the entire proceeds of the check. The supplier should not, without qualification, be able to recover the entire amount of the check from the bank that converted the check. Depending upon the contract between the contractor and the supplier, the amount of the check may be due entirely to the contractor, in which case there should be no recovery, entirely to the supplier, in which case recovery should be for the entire amount, or part may be due to one and the rest to the other, in which case recovery should be limited to the amount due to the supplier.

3. Subsection (3) of former Section 3-419 drew criticism from the courts, that saw no reason why a depositary bank should have the defense stated in the subsection See *Knesz v. Central Jersey Bank & Trust Co.,* 477 A.2d 806 (N.J. 1984). The depositary bank is ultimately liable in the case of a forged indorsement check because of its warranty to the payor bank under Section 4-208(a)(1) and it is usually the most convenient defendant in cases involving multiple checks drawn on different banks. There is no basis for requiring the owner of the check to bring multiple actions against the

various payor banks and to require those banks to assert warranty rights against the depositary bank. In revised Article 3, the defense provided by Section 3-420(c) is limited to collecting banks other than the depositary bank. If suit is brought against both the payor bank and the depositary bank, the owner, of course, is entitled to but one recovery.

Part 5
Dishonor

Idaho Code § 28-3-501

§ 28-3-501. Presentment. — (1) "Presentment" means a demand made by or on behalf of a person entitled to enforce an instrument (i) to pay the instrument made to the drawee or a party obliged to pay the instrument or, in the case of a note or accepted draft payable at a bank, to the bank, or (ii) to accept a draft made to the drawee.

(2) The following rules are subject to chapter 4[, title 28, Idaho Code], agreement of the parties, and clearing-house rules and the like: (a) Presentment may be made at the place of payment of the instrument and must be made at the place of payment if the instrument is payable at a bank in the United States; may be made by any commercially reasonable means, including an oral, written or electronic communication; is effective when the demand for payment or acceptance is received by the person to whom presentment is made; and is effective if made to any one (1) of two (2) or more makers, acceptors, drawees or other payors.

(b) Upon demand of the person to whom presentment is made, the person making presentment must (i) exhibit the instrument, (ii) give reasonable identification and, if presentment is made on behalf of another person, reasonable evidence of authority to do so, and (iii) sign a receipt on the instrument for any payment made or surrender the instrument if full payment is made.

(c) Without dishonoring the instrument, the party to whom presentment is made may (i) return the instrument for lack of a necessary indorsement, or (ii) refuse payment or acceptance for failure of the presentment to comply with the terms of the instrument, an agreement of the parties, or other applicable law or rule.

(d) The party to whom presentment is made may treat presentment as occurring on the next business day after the day of presentment if the party to whom presentment is made has established a cut-off hour not

earlier than 2 p.m. for the receipt and processing of instruments presented for payment or acceptance and presentment is made after the cut-off hour.

History.

I.C., § 28-3-501, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-501 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertion in the introductory paragraph in subsection (2) was added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

After banking hours.

Burden of proof.

Failure of bank.

Limitation of action.

Lost check.

Payment of dishonored check.

Payment without production of note.

Reasonable time.

After Banking Hours.

Where check has been received after banking hours, day check was received should not be counted. Bistline v. Benting, 39 Idaho 534, 228 P. 309 (1924).

By general business custom of depositing checks in payee's bank for collection instead of presenting them in person to drawee bank, it was

sufficient to so deposit check received after banking hours on the following day. Bistline v. Benting, 39 Idaho 534, 228 P. 309 (1924).

Burden of Proof.

Where special defense of holder's default in presenting check is relied on, burden was on drawer to prove fact and extent of his loss. Sims v. Hunter, 44 Idaho 505, 258 P. 550 (1927).

Failure of Bank.

Presentment of check was not required when drawee bank closed its doors before reasonable time for presentment had expired. Bistline v. Benting, 39 Idaho 534, 228 P. 309 (1924).

Limitation of Action.

The statute of limitations begins to run from the date of execution of a note, and evidence that the parties agreed the statute would not begin to run until demand was made was inadmissible. Mahas v. Kasiska, 47 Idaho 179, 276 P. 315 (1928).

Lost Check.

Holder's agent, who had a copy of a lost check, should have presented it to preserve the rights of the holder against drawer and prior indorsers. Matlock v. Citizens' Nat'l Bank, 43 Idaho 214, 250 P. 648 (1926).

Payment of Dishonored Check.

Where creditor redeposited check which had been dishonored on November 28, 1979, and received funds on February 14, 1980, such transaction was a completion of original November transaction, rather than an extension of additional credit as new value in shipping goods it had held after the check was dishonored; thus, the shipment was not a transfer contemporaneous with the promise to pay the dishonored check under this section. McClendon v. Cal-Wood Door (In re Wadsworth Bldg. Components, Inc.), 10 Bankr. 662 (Bankr. D. Idaho 1981).

Payment Without Production of Note.

The maker of a note who paid the same without seeing and demanding production of the note must prove that payment was made to the holder or his agent. Nielson v. Westrom, 46 Idaho 686, 270 P. 1054 (1928).

Reasonable Time.

What was a reasonable time under former statute was one of fact to be determined by the circumstances of each particular case. Sheffield v. Cleland, 19 Idaho 612, 115 P. 20 (1911).

Where no question of fact was in dispute, determination of what was reasonable diligence in presenting check was one of law for court. Bistline v. Benting, 39 Idaho 534, 228 P. 309 (1924); Campbell v. Shark, 46 Idaho 278, 267 P. 458 (1928).

Where transaction and bank were in one locality, in absence of clearly excusable circumstances or conditions, five days after delivery constitutes unreasonable time within which to present check for payment or at least to deposit for collection. Campbell v. Shark, 46 Idaho 278, 267 P. 458 (1928).

That a check was received after banking hours, deposited in the payee's bank the following day, and that payee's bank could not present it on next business day because of failure of drawee did not show negligence in presentment in a reasonable time. Clarke v. Davis, 48 Idaho 214, 281 P. 3 (1929).

Official Comment

Subsection (a) defines presentment. Subsection (b)(1) states the place and manner of presentment. Electronic presentment is authorized. The communication of the demand for payment or acceptance is effective when received. Subsection (b)(2) restates former Section 3-505. Subsection (b)(2)(i) allows the person to whom presentment is made to require exhibition of the instrument, unless the parties have agreed otherwise as in an electronic presentment agreement. Former Section 3-507(3) is the antecedent of subsection (b)(3)(i). Since a payor must decide whether to pay or accept on the day of presentment, subsection (b)(4) allows the payor to set a cut-off hour for receipt of instruments presented.

§ 28-3-502. Dishonor. — (1) Dishonor of a note is governed by the following rules:

(a) If the note is payable on demand, the note is dishonored if presentment is duly made to the maker and the note is not paid on the day of presentment.

(b) If the note is not payable on demand and is payable at or through a bank or the terms of the note require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.

(c) If the note is not payable on demand and paragraph (b) of this subsection does not apply, the note is dishonored if it is not paid on the day it becomes payable.

(2) Dishonor of an unaccepted draft other than a documentary draft is governed by the following rules:

(a) If a check is duly presented for payment to the payor bank otherwise than for immediate payment over the counter, the check is dishonored if the payor bank makes timely return of the check or sends timely notice of dishonor or nonpayment under section 28-4-301 or 28-4-302[, Idaho Code,] or becomes accountable for the amount of the check under section 28-4-302[, Idaho Code].

(b) If a draft is payable on demand and paragraph (a) of this subsection does not apply, the draft is dishonored if presentment for payment is duly made to the drawee and the draft is not paid on the day of presentment.

(c) If a draft is payable on a date stated in the draft, the draft is dishonored if (i) presentment for payment is duly made to the drawee and payment is not made on the day the draft becomes payable or the day of presentment, whichever is later, or (ii) presentment for acceptance is duly made before the day the draft becomes payable and the draft is not accepted on the day of presentment.

(d) If a draft is payable on elapse of a period of time after sight or acceptance, the draft is dishonored if presentment for acceptance is duly

made and the draft is not accepted on the day of presentment.

(3) Dishonor of an unaccepted documentary draft occurs according to the rules stated in subsection (2)(b), (c) and (d) of this section, except that payment or acceptance may be delayed without dishonor until no later than the close of the third business day of the drawee following the day on which payment or acceptance is required by those paragraphs.

(4) Dishonor of an accepted draft is governed by the following rules:

(a) If the draft is payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and the draft is not paid on the day of presentment.

(b) If the draft is not payable on demand, the draft is dishonored if presentment for payment is duly made to the acceptor and payment is not made on the day it becomes payable or the day of presentment, whichever is later.

(5) In any case in which presentment is otherwise required for dishonor under this section and presentment is excused under section 28-3-504[, Idaho Code,] dishonor occurs without presentment if the instrument is not duly accepted or paid.

(6) If a draft is dishonored because timely acceptance of the draft was not made and the person entitled to demand acceptance consents to a late acceptance, from the time of acceptance the draft is treated as never having been dishonored.

History.

I.C., § 28-3-502, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-502 was repealed. See Prior Laws, § 28-3-101.

Compiler’s Notes.

The bracketed insertions in paragraph (2)(a) and in subsection (5) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Section 3-415 provides that an indorser is obliged to pay an instrument if the instrument is dishonored and is discharged if the indorser is entitled to notice of dishonor and notice is not given. Under Section 3-414, the drawer is obliged to pay an unaccepted draft if it is dishonored. The drawer, however, is not entitled to notice of dishonor except to the extent required in a case governed by Section 3-414(d). Part 5 tells when an instrument is dishonored (Section 3-502) and what it means to give notice of dishonor (Section 3-503). Often dishonor does not occur until presentment (Section 3-501), and frequently presentment and notice of dishonor are excused (Section 3-504).

2. In the great majority of cases presentment and notice of dishonor are waived with respect to notes. In most cases a formal demand for payment to the maker of the note is not contemplated. Rather, the maker is expected to send payment to the holder of the note on the date or dates on which payment is due. If payment is not made when due, the holder usually makes a demand for payment, but in the normal case in which presentment is waived, demand is irrelevant and the holder can proceed against indorsers when payment is not received. Under former Article 3, in the small minority of cases in which presentment and dishonor were not waived with respect to notes, the indorser was discharged from liability (former Section 3-502(1)(a)) unless the holder made presentment to the maker on the exact day the note was due (former Section 3-503(1)(c)) and gave notice of dishonor to the indorser before midnight of the third business day after dishonor (former Section 3-508(2)). These provisions are omitted from Revised Article 3 as inconsistent with practice which seldom involves face-to-face dealings.

3. Subsection (a) applies to notes. Subsection (a)(1) applies to notes payable on demand. Dishonor requires presentment, and dishonor occurs if payment is not made on the day of presentment. There is no change from previous Article 3. Subsection (a)(2) applies to notes payable at a definite time if the note is payable at or through a bank or, by its terms, presentment is required. Dishonor requires presentment, and dishonor occurs if payment is not made on the due date or the day of presentment if presentment is made after the due date. Subsection (a)(3) applies to all other notes. If the

note is not paid on its due date it is dishonored. This allows holders to collect notes in ways that make sense commercially without having to be concerned about a formal presentment on a given day.

4. Subsection (b) applies to unaccepted drafts other than documentary drafts. Subsection (b)(1) applies to checks. Except for checks presented for immediate payment over the counter, which are covered by subsection (b)(2), dishonor occurs according to rules stated in Article 4. Those rules contemplate four separate situations that warrant discussion. The first two situations arise in the normal course of affairs, in which the drawee bank makes settlement for the amount of the check to the presenting bank. In the first situation, the drawee bank under Section 4-301 recovers this settlement if it returns the check by its midnight deadline (Section 4-104). In that case the check is not paid and dishonor occurs under Section 3-502(b)(1). The second situation arises if the drawee bank has made such a settlement and does not return the check or give notice of dishonor or nonpayment within the midnight deadline. In that case, the settlement becomes final payment of the check under Section 4-215. Because the drawee bank already has paid such an item, it cannot be "accountable" for the item under the terms of Section 4-302(a)(1). Thus, no dishonor occurs regardless of whether the drawee bank retains the check indefinitely or for some reason returns the check after its midnight deadline.

The third and fourth situations arise less commonly, in cases in which the drawee bank does not settle for the check when it is received. Under Section 4-302 if the drawee bank is not also the depositary bank and retains the check without settling for it beyond midnight of the day it is presented for payment, the bank at that point becomes "accountable" for the amount of the check, i.e., it is obliged to pay the amount of the check. If the drawee bank is also the depositary bank, the bank becomes accountable for the amount of the check if the bank does not pay the check or return it or send notice of dishonor by its midnight deadline. Hence, if the drawee bank is also the depositary bank and does not either settle for the check when it is received (a settlement that would ripen into final payment if the drawee bank failed to take action to recover the settlement by its midnight deadline) or return the check or an appropriate notice by its midnight deadline, the drawee bank will become accountable for the amount of the check under Section 4-302. Thus, in all cases in which the drawee bank becomes

accountable under Section 4-302, the check has not been paid (either by a settlement that became unrecoverable or otherwise) and thus, under Section 3-502(b)(1), the check is dishonored.

The fact that a bank that is accountable for the amount of the check under Section 4-302 is obliged to pay the check does not mean that the check has been paid. Indeed, because each of the paragraphs of Section 4-302(b) is limited by its terms to situations in which a bank has not paid the item, a drawee bank will be accountable under Section 4-302 only in situations in which it has not previously paid the check. Section 3-502(b)(1) reflects the view that a person presenting a check is entitled to payment, not just the ability to hold the drawee accountable under Section 4-302. If that payment is not made in a timely manner, the check is dishonored.

Regulation CC Section 229.36(d) provides that settlement between banks for the forward collection of checks is final. The relationship of that section to Articles 3 and 4 is discussed in the Commentary to that section.

Subsection (b)(2) applies to demand drafts other than those governed by subsection (b)(1). It covers checks presented for immediate payment over the counter and demand drafts other than checks. Dishonor occurs if presentment for payment is made and payment is not made on the day of presentment.

Subsection (b)(3) and (4) applies to time drafts. An unaccepted time draft differs from a time note. The maker of a note knows that the note has been issued, but the drawee of a draft may not know that a draft has been drawn on it. Thus, with respect to drafts, presentment for payment or acceptance is required. Subsection (b)(3) applies to drafts payable on a date stated in the draft. Dishonor occurs if presentment for payment is made and payment is not made on the day the draft becomes payable or the day of presentment if presentment is made after the due date. The holder of an unaccepted draft payable on a stated date has the option of presenting the draft for acceptance before the day the draft becomes payable to establish whether the drawee is willing to assume liability by accepting. Under subsection (b)(3)(ii) dishonor occurs when the draft is presented and not accepted. Subsection (b)(4) applies to unaccepted drafts payable on elapse of a period of time after sight or acceptance. If the draft is payable 30 days after sight, the draft must be presented for acceptance to start the running of the 30-day

period. Dishonor occurs if it is not accepted. The rules in subsection (b)(3) and (4) follow former Section 3-501(1)(a).

5. Subsection (c) gives drawees an extended period to pay documentary drafts because of the time that may be needed to examine the documents. The period prescribed is that given by Section 5-112 in cases in which a letter of credit is involved.

6. Subsection (d) governs accepted drafts. If the acceptor's obligation is to pay on demand the rule, stated in subsection (d)(1), is the same as for that of a demand note stated in subsection (a)(1). If the acceptor's obligation is to pay at a definite time the rule, stated in subsection (d)(2), is the same as that of a time note payable at a bank stated in subsection (b)(2).

7. Subsection (e) is a limitation on subsection (a)(1) and (2), subsection (b), subsection (c), and subsection (d). Each of those provisions states dishonor as occurring after presentment. If presentment is excused under Section 3-504, dishonor occurs under those provisions without presentment if the instrument is not duly accepted or paid.

8. Under subsection (b)(3)(ii) and (4) if a draft is presented for acceptance and the draft is not accepted on the day of presentment, there is dishonor. But after dishonor, the holder may consent to late acceptance. In that case, under subsection (f), the late acceptance cures the dishonor. The draft is treated as never having been dishonored. If the draft is subsequently presented for payment and payment is refused dishonor occurs at that time.

§ 28-3-503. Notice of dishonor. — (1) The obligation of an indorser stated in section 28-3-415(1)[, Idaho Code,] and the obligation of a drawer stated in section 28-3-414(4)[, Idaho Code,] may not be enforced unless, (i) the indorser or drawer is given notice of dishonor of the instrument complying with this section, or (ii) notice of dishonor is excused under section 28-3-504(2)[, Idaho Code].

(2) Notice of dishonor may be given by any person; may be given by any commercially reasonable means, including an oral, written or electronic communication; and is sufficient if it reasonably identifies the instrument and indicates that the instrument has been dishonored or has not been paid or accepted. Return of an instrument given to a bank for collection is sufficient notice of dishonor.

(3) Subject to section 28-3-504(3)[, Idaho Code,] with respect to an instrument taken for collection by a collecting bank, notice of dishonor must be given (i) by the bank before midnight of the next banking day following the banking day on which the bank receives notice of dishonor of the instrument, or (ii) by any other person within thirty (30) days following the day on which the person receives notice of dishonor. With respect to any other instrument, notice of dishonor must be given within thirty (30) days following the day on which dishonor occurs.

History.

I.C., § 28-3-503, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-503 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (1) and (3) were added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 328 et seq.

Official Comment

1. Subsection (a) is consistent with former Section 3-501(2)(a), but notice of dishonor is no longer relevant to the liability of a drawer except for the case of a draft accepted by an acceptor other than a bank. Comments 2 and 4 to Section 3-414. There is no reason why drawers should be discharged on instruments they draw until payment or acceptance. They are entitled to have the instrument presented to the drawee and dishonored (Section 3-414(b)) before they are liable to pay, but no notice of dishonor need be made to them as a condition of liability. Subsection (b), which states how notice of dishonor is given, is based on former Section 3-508(3).

2. Subsection (c) replaces former Section 3-508(2). It differs from that section in that it provides a 30-day period for a person other than a collecting bank to give notice of dishonor rather than the three-day period allowed in former Article 3. Delay in giving notice of dishonor may be excused under Section 3-504(c).

§ 28-3-504. Excused presentment and notice of dishonor. — (1) Presentment for payment or acceptance of an instrument is excused if (i) the person entitled to present the instrument cannot with reasonable diligence make presentment, (ii) the maker or acceptor has repudiated an obligation to pay the instrument or is dead or in insolvency proceedings, (iii) by the terms of the instrument presentment is not necessary to enforce the obligation of indorsers or the drawer, (iv) the drawer or indorser whose obligation is being enforced has waived presentment or otherwise has no reason to expect or right to require that the instrument be paid or accepted, or (v) the drawer instructed the drawee not to pay or accept the draft or the drawee was not obligated to the drawer to pay the draft.

(2) Notice of dishonor is excused if (i) by the terms of the instrument notice of dishonor is not necessary to enforce the obligation of a party to pay the instrument, or (ii) the party whose obligation is being enforced waived notice of dishonor. A waiver of presentment is also a waiver of notice of dishonor.

(3) Delay in giving notice of dishonor is excused if the delay was caused by circumstances beyond the control of the person giving the notice and the person giving the notice exercised reasonable diligence after the cause of the delay ceased to operate.

History.

I.C., § 28-3-504, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-504 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law "Protest" defined.

Waiver.

"Protest" Defined.

Word "protest" in its popular sense, as generally and ordinarily used in commercial transactions, covered and included all those acts and things necessary to be done in order to bind indorsers for the payment of the debt evidenced by paper indorsed. Bank of Montpelier v. Montpelier Lumber Co., 16 Idaho 730, 102 P. 685 (1909).

Waiver.

Presentment for payment was waived by waiver of protest and notice of protest. Bank of Montpelier v. Montpelier Lumber Co., 16 Idaho 730, 102 P. 685 (1909).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 318 et seq.

Official Comment

Section 3-504 is largely a restatement of former Section 3-511. Subsection (4) of former Section 3-511 is replaced by Section 3-502(f).

§ 28-3-505. Evidence of dishonor. — (1) The following are admissible as evidence and create a presumption of dishonor and of any notice of dishonor stated:

(a) A document regular in form as provided in subsection (2) of this section which purports to be a protest;

(b) A purported stamp or writing of the drawee, payor bank or presenting bank on or accompanying the instrument stating that acceptance or payment has been refused unless reasons for the refusal are stated and the reasons are not consistent with dishonor;

(c) A book or record of the drawee, payor bank or collecting bank, kept in the usual course of business which shows dishonor, even if there is no evidence of who made the entry.

(2) A protest is a certificate of dishonor made by a United States consul or vice consul, or a notary public or other person authorized to administer oaths by the law of the place where dishonor occurs. It may be made upon information satisfactory to that person. The protest must identify the instrument and certify either that presentment has been made or, if not made, the reason why it was not made, and that the instrument has been dishonored by nonacceptance or nonpayment. The protest may also certify that notice of dishonor has been given to some or all parties.

History.

I.C., § 28-3-505, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-505 was repealed. See Prior Laws, § 28-3-101.

Official Comment

Protest is no longer mandatory and must be requested by the holder. Even if requested, protest is not a condition to the liability of indorsers or

drawers. Protest is a service provided by the banking system to establish that dishonor has occurred. Like other services provided by the banking system, it will be available if market incentives, interbank agreements, or governmental regulations require it, but liabilities of parties no longer rest on it. Protest may be a requirement for liability on international drafts governed by foreign law which this Article cannot affect.

§ 28-3-506 — 28-3-511. Time allowed for acceptance or payment — Dishonor — Holder's right of recourse — Term allowing re-presentment — Notice — Protest — Noting for protest — Evidence and notice of dishonor — Checks dishonored by nonacceptance or nonpayment — Liability for — Interest — Rate — Collection costs and attorneys' fees — Statutory form for notice of dishonor — Consequences for failing to comply with requirements — Waived or excused presentment, protest or notice of dishonor or delay. [Repealed.]

STATUTORY NOTES

Prior Laws.

Former §§ 28-3-506 to 28-3-511 were repealed. See Prior Laws, § 28-3-101.

Part 6
Discharge and Payment

• Title 28 •, « Ch. 3 », « Pt. 6 », • § 28-3-601 »

Idaho Code § 28-3-601

§ 28-3-601. Discharge and effect of discharge. — (1) The obligation of a party to pay the instrument is discharged as stated in this chapter or by an act or agreement with the party which would discharge an obligation to pay money under a simple contract.

(2) Discharge of the obligation of a party is not effective against a person acquiring rights of a holder in due course of the instrument without notice of the discharge.

History.

I.C., § 28-3-601, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-601 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Decisions Under Prior Law

Renewal notes.

Application.

The methods of discharge listed by former law were exclusive. Everton v. Blair, 99 Idaho 14, 576 P.2d 585 (1978).

Burden of Proof.

The payor assumed the burden of proving that the payment of a note to one not in possession thereof was made to the holder or his agent, and the rule was not changed by the fact that payment was made to the original payee. Nielson v. Westrom, 46 Idaho 686, 270 P. 1054 (1928).

Checks.

Where check was received by drawee bank as collecting agent or holder and as drawee, and retained without charging it to depositor's account, there was no payment of the instrument. Davison v. Allen, 47 Idaho 405, 276 P. 43 (1929).

Where collecting bank accepted the maker's check, acting as the holder's agent, in payment of a note, but did not attempt to cash the check until after failure of the bank on which drawn, the check constituted payment and the holder of the note could not recover from the maker. Fisher v. Farmers' Coop. Irrigation Co., 49 Idaho 343, 288 P. 164 (1930).

Novation.

A person who relied on a novation must have established that the new obligation was intended as a substitution and extinguishment of the old one. Gibbs v. Christensen, 47 Idaho 658, 277 P. 814 (1929).

Payment.

Payment of the note meant discharge of the liability. Miller v. Del Rio Mining & Milling Co., 25 Idaho 83, 136 P. 448 (1913).

Plea of Payment.

The plea of payment or partial payment was held to be established in the following cases: Quayle v. Ream, 15 Idaho 666, 99 P. 707 (1909); Home Land Co. v. Osborn, 19 Idaho 95, 112 P. 764 (1910).

Possession of Note.

Possession of a note uncancelled by a person other than the maker was prima facie evidence that the debt evidenced thereby was unpaid. Sheffield v. Cleland, 19 Idaho 612, 115 P. 20 (1911).

Proof of Payment.

The delivery of a land certificate which has been cancelled by the state did not constitute a payment of a note. First Bank v. McNally, 42 Idaho 443, 246 P. 5 (1926).

A marginal notation, made with a rubber stamp on the record of a mortgage securing a note, certifying payment and discharge, was in effect a receipt, and parol evidence was admissible in an action on the note to show a mistake in the acknowledgment of payment. Berryman v. Dore, 43 Idaho 327, 251 P. 757 (1926).

The fact that a holder of a note accepted and cashed a check drawn by the maker for part of the amount of the note, bearing a notation of settlement, was sufficient to show an intent to cancel the obligation where no further demand was made for two years. Finlayson v. Harris, 49 Idaho 697, 291 P. 1071 (1930).

Renewal Notes.

The intent of the parties governed whether giving a renewal note operated as a discharge or satisfaction of the original. Fidelity State Bank v. Miller, 29 Idaho 777, 162 P. 244 (1916).

Cancellation of an old note was good consideration for a new one. Fidelity State Bank v. Miller, 29 Idaho 777, 162 P. 244 (1916).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 354 et seq.

C.J.S. — 10 C.J.S., Bills and Notes, § 253 et seq.

Official Comment

Subsection (a) replaces subsections (1) and (2) of former Section 3-601. Subsection (b) restates former Section 3-602. Notice of discharge is not treated as notice of a defense that prevents holder in due course status.

Section 3-302(b). Discharge is effective against a holder in due course only if the holder had notice of the discharge when holder in due course status was acquired. For example, if an instrument bearing a cancelled indorsement is taken by a holder, the holder has notice that the indorser has been discharged. Thus, the discharge is effective against the holder even if the holder is a holder in due course.

§ 28-3-602. Payment. — (1) Subject to subsection (2) of this section, an instrument is paid to the extent payment is made (i) by or on behalf of a party obliged to pay the instrument, and (ii) to a person entitled to enforce the instrument. To the extent of the payment, the obligation of the party obliged to pay the instrument is discharged even though payment is made with knowledge of a claim to the instrument under section 28-3-306[, Idaho Code,] by another person.

(2) The obligation of a party to pay the instrument is not discharged under subsection (1) of this section if: (a) A claim to the instrument under section 28-3-306[, Idaho Code,] is enforceable against the party receiving payment and (i) payment is made with knowledge by the payor that payment is prohibited by injunction or similar process of a court of competent jurisdiction, or (ii) in the case of an instrument other than a cashier's check, teller's check or certified check, the party making payment accepted, from the person having a claim to the instrument, indemnity against loss resulting from refusal to pay the person entitled to enforce the instrument; or (b) The person making payment knows that the instrument is a stolen instrument and pays a person it knows is in wrongful possession of the instrument.

History.

I.C., § 28-3-602, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-602 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsection (1) and paragraph (2)(a) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Burden of Proof.

The payor assumed the burden of proving that the payment of a note to one not in possession thereof was made to the holder or his agent, and the rule is not changed by the fact that payment was made to the original payee. Nielson v. Westrom, 46 Idaho 686, 270 P. 1054 (1928).

Checks.

Where check was received by drawee bank as collecting agent or holder and as drawee, and retained without charging it to depositor's account, there was no payment of the instrument. Davison v. Allen, 47 Idaho 405, 276 P. 43 (1929).

Where collecting bank accepted the maker's check, acting as the holder's agent, in payment of a note, but did not attempt to cash the check until after failure of the bank on which it was drawn, the check constituted payment and the holder of the note could not recover from the maker. Fisher v. Farmers' Coop. Irrigation Co., 49 Idaho 343, 288 P. 164 (1930).

Fiduciaries.

Holder of note, who bought a draft for which note was executed, with money held by him only for investment for another, was entitled to prosecute an action on the note in his own name. Ritter v. Moore, 64 Idaho 144, 128 P.2d 639 (1942).

Holder for Collection.

The holder of a note indorsed to another for collection could recover thereon in his own name. McCornick & Co. v. Tolmie Bros., 42 Idaho 1, 243 P. 355 (1926).

Novation.

A person relying on a novation must establish that the new obligation was intended as a substitution and extinguishment of the old one. Gibbs v. Christensen, 47 Idaho 658, 277 P. 814 (1929).

Payment.

Payment of the note meant discharge of the liability. Miller v. Del Rio Mining & Milling Co., 25 Idaho 83, 136 P. 448 (1913).

Pleading and Practice.

In an action on notes representing a part of the purchase price of timber, amendment of the answer to conform to proof that the contract under which the notes were given had been terminated by oral agreement should have been allowed, in the absence of substantial variance, surprise or prejudice. Milwaukee Land Co. v. Bogle, 60 Idaho 451, 92 P.2d 1065 (1939).

In action on note, it was not error for the court to allow to be introduced in evidence certain documents after plaintiff had concluded all testimony. C.I.T. Corp. v. Elliott, 66 Idaho 384, 159 P.2d 891 (1945).

Plea of Payment.

The plea of payment or partial payment was held to be established in the following cases: Quayle v. Ream, 15 Idaho 666, 99 P. 707 (1909); Home Land Co. v. Osborn, 19 Idaho 95, 112 P. 764 (1910).

Possession of Note.

Possession of a note uncancelled by a person other than the maker was prima facie evidence that the debt evidenced thereby was unpaid. Sheffield

v. Cleland, 19 Idaho 612, 115 P. 200 (1911).

Presumption of Ownership.

In absence of a specific agreement or understanding that a negotiable instrument should be a pledge, holder thereof was presumed to be owner and was entitled to maintain his action thereon. Home Land Co. v. Osborn, 19 Idaho 95, 112 P. 764 (1910).

The possession of an instrument payable to order and properly indorsed was prima facie evidence of ownership. Home Land Co. v. Osborn, 19 Idaho 95, 112 P. 764 (1910); McCornick & Co. v. Tolmie Bros., 42 Idaho 1, 243 P. 355 (1926); Ritter v. Moore, 64 Idaho 144, 128 P.2d 639 (1942).

The presumption of ownership of a negotiable instrument arising from possession thereof was rebuttable. Portland Cattle Loan Co. v. Gemmell, 41 Idaho 756, 242 P. 798 (1925).

Any one in possession of a negotiable instrument may maintain an action thereon, and possession of a note and pleading thereof was sufficient evidence of ownership to put defendant on his proof. C.I.T. Corp. v. Elliott, 66 Idaho 384, 159 P.2d 891 (1945).

Proof of Payment.

The delivery of a land certificate which had been cancelled by the state did not constitute a payment of a note. First Bank v. McNally, 42 Idaho 443, 246 P. 5 (1926).

A marginal notation, made with a rubber stamp on the record of a mortgage securing a note, certifying payment and discharge, was in effect a receipt, and parol evidence was admissible in an action on the note to show a mistake in the acknowledgment of payment. Berryman v. Dore, 43 Idaho 327, 251 P. 757 (1926).

The fact that a holder of a note accepted and cashed a check drawn by the maker for part of the amount of a note, bearing a notation of settlement was sufficient to show an intent to cancel the obligation where no further demand was made for two years. Finlayson v. Harris, 49 Idaho 697, 291 P. 1071 (1930).

Renewal Notes.

Cancellation of an old note was good consideration for a new one. Fidelity State Bank v. Miller, 29 Idaho 777, 162 P. 244 (1916).

The intention of the parties governed whether giving a renewal note operated as a discharge or satisfaction of the original. Fidelity State Bank v. Miller, 29 Idaho 777, 162 P. 244 (1916).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 362 et seq.

C.J.S. — 10 C.J.S., Bills and Notes, § 253 et seq.

Official Comment

This section replaces former Section 3-603(1). The phrase "claim to the instrument" in subsection (a) means, by reference to Section 3-306, a claim of ownership or possession and not a claim in recoupment. Subsection (b)(1)(ii) is added to conform to Section 3-411. Section 3-411 is intended to discourage an obligated bank from refusing payment of a cashier's check, certified check, or dishonored teller's check at the request of a claimant to the check who provided the bank with indemnity against loss. See Comment 1 to Section 3-411. An obligated bank that refuses payment under those circumstances not only remains liable on the check but may also be liable to the holder of the check for consequential damages. Section 3-602(b)(1)(ii) and Section 3-411, read together, change the rule of former Section 3-603(1) with respect to the obligation of the obligated bank on the check. Payment to the holder of a cashier's check, teller's check, or certified check discharges the obligation of the obligated bank on the check to both the holder and the claimant even though indemnity has been given by the person asserting the claim. If the obligated bank pays the check in violation of an agreement with the claimant in connection with the indemnity agreement, any liability that the bank may have for violation of the agreement is not governed by Article 3, but is left to other law. This section continues the rule that the obligor is not discharged on the instrument if payment is made in violation of an injunction against payment. See Section 3-411(c)(iv).

§ 28-3-603. Tender of payment. — (1) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument, the effect of tender is governed by principles of law applicable to tender of payment under a simple contract.

(2) If tender of payment of an obligation to pay an instrument is made to a person entitled to enforce the instrument and the tender is refused, there is discharge, to the extent of the amount of the tender, of the obligation of an indorser or accommodation party having a right of recourse with respect to the obligation to which the tender relates.

(3) If tender of payment of an amount due on an instrument is made to a person entitled to enforce the instrument, the obligation of the obligor to pay interest after the due date on the amount tendered is discharged. If presentment is required with respect to an instrument and the obligor is able and ready to pay on the due date at every place of payment stated in the instrument, the obligor is deemed to have made tender of payment on the due date to the person entitled to enforce the instrument.

History.

I.C., § 28-3-603, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-603 was repealed. See Prior Laws, § 28-3-101.

CASE NOTES

Improper Tender.

Where a third party agreed to purchase the buyers' interest in a note for an undisclosed amount up to $ 225,000, subject to certain conditions, the offer does not constitute a tender of payment under subsection (2), given that (1) the buyers never offered to pay the sellers the real amount of the debt, and (2) the offer was not unconditional. Indian Springs LLC v. Indian

Springs Land Inv., LLC, 147 Idaho 737, 215 P.3d 457 (2009), cert. denied, 559 U.S. 944, 176 L. Ed. 3d 121, 130 S. Ct. 1512 (2010).

Decisions Under Prior Law

Ability and Intent to Pay.

Makers of a note demonstrated an ability and intent to effectuate payment of note by presenting a cashier's check to trustee; therefore, adequate physical tender of full satisfaction of the debt was made and makers were not liable for any subsequent accrual of interest. Brinton v. Haight, 125 Idaho 324, 870 P.2d 677 (Ct. App. 1994).

Burden of Proof.

The maker of a note alleging an oral renunciation of the debt and surrender of the note by the payee, since deceased, had the burden of establishing by a preponderance of the evidence such renunciation coupled with the delivery of the note to the maker by the payee during her lifetime. Anderson v. Ruberg, 66 Idaho 417, 160 P.2d 456 (1945).

Cancellation without Consideration.

For a promissory note to be cancelled without consideration, the cancellation or renunciation of rights must be done by a signed writing. Everton v. Blair, 99 Idaho 14, 576 P.2d 585 (1978).

Decedent, Renunciation by.

Evidence of alleged oral renunciation by a decedent was to be received with caution. Anderson v. Ruberg, 66 Idaho 417, 160 P.2d 456 (1945).

Defenses.

Where the affidavit of the bank stated that all prior notes had been cancelled and that the borrower was not indebted to the bank on any prior notes, such was an effective renunciation of the rights of the bank and an effective defense in the borrower to any later action on the prior notes. F & M State Bank v. Lloyd, 99 Idaho 416, 582 P.2d 1094 (1978).

Instruction to Jury.

Instruction, which announced that if jury found "that the plaintiff renounced in writing his rights against the defendant upon the note and that such renunciation was an absolute and unconditional renunciation," then their verdict should be for defendant, was erroneous, where there is no explanation that release would not have that effect if same was made unintentionally or by mistake. Berryman v. Dore, 43 Idaho 327, 251 P. 757 (1926).

Questions of Fact.

The question of whether or not a debt was renounced and the note surrendered to the maker were questions of fact for the jury to determine from all the evidence and surrounding circumstances developed upon the trial. Anderson v. Ruberg, 66 Idaho 417, 160 P.2d 456 (1945).

Reversible Error.

Where there was no showing of the elements of an estoppel waiver, the payer of a promissory note could not discharge the note by a simple oral statement and the submission of an instruction on the law of waiver was an error warranting a new trial. Everton v. Blair, 99 Idaho 14, 576 P.2d 585 (1978).

Satisfaction of Mortgage.

Satisfaction of mortgage stamped on record and signed by mortgagee is not contractual release or renunciation of rights, but mere receipt permitting parol evidence that payment was not made and that release of note secured

by mortgage was unintentional and by mistake. Berryman v. Dore, 43 Idaho 327, 251 P. 757 (1926).

Waiver of Restrictive Indorsement.

Drawer of trade acceptance, also the payee, could have waived restriction "for deposit only" which he placed thereon, sell the acceptance to the bank of deposit, and convert the bank into a bona fide holder in due course. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 362 et seq.

Official Comment

Section 3-603 replaces former Section 3-604. Subsection (a) generally incorporates the law of tender of payment applicable to simple contracts. Subsections (b) and (c) state particular rules. Subsection (b) replaces former Section 3-604(2). Under subsection (b) refusal of a tender of payment discharges any indorser or accommodation party having a right of recourse against the party making the tender. Subsection (c) replaces former Section 3-604(1) and (3).

§ 28-3-604. Discharge by cancellation or renunciation. — (1) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument (i) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation or cancellation of the instrument, cancellation or striking out of the party's signature, or the addition of words to the instrument indicating discharge, or (ii) by agreeing not to sue or otherwise renouncing rights against the party by a signed writing.

(2) Cancellation or striking out of an indorsement pursuant to subsection (1) of this section does not affect the status and rights of a party derived from the indorsement.

History.

I.C., § 28-3-604, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-604 was repealed. See Prior Laws, § 28-3-101.

Official Comment Section 3-604 replaces former Section 3-605.

§ 28-3-605. Discharge of indorsers and accommodation parties. — (1) In this section, the term "indorser" includes a drawer having the obligation described in section 28-3-414(4)[, Idaho Code].

(2) Discharge, under section 28-3-604[, Idaho Code,] of the obligation of a party to pay an instrument does not discharge the obligation of an indorser or accommodation party having a right of recourse against the discharged party.

(3) If a person entitled to enforce an instrument agrees, with or without consideration, to an extension of the due date of the obligation of a party to pay the instrument, the extension discharges an indorser or accommodation party having a right of recourse against the party whose obligation is extended to the extent the indorser or accommodation party proves that the extension caused loss to the indorser or accommodation party with respect to the right of recourse.

(4) If a person entitled to enforce an instrument agrees, with or without consideration, to a material modification of the obligation of a party other than an extension of the due date, the modification discharges the obligation of an indorser or accommodation party having a right of recourse against the person whose obligation is modified to the extent the modification causes loss to the indorser or accommodation party with respect to the right of recourse. The loss suffered by the indorser or accommodation party as a result of the modification is equal to the amount of the right of recourse unless the person enforcing the instrument proves that no loss was caused by the modification or that the loss caused by the modification was an amount less than the amount of the right of recourse.

(5) If the obligation of a party to pay an instrument is secured by an interest in collateral and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of an indorser or accommodation party having a right of recourse against the obligor is discharged to the extent of the impairment. The value of an interest in collateral is impaired to the extent (i) the value of the interest is reduced to an amount less than the amount of the right of recourse of the party asserting discharge, or (ii) the reduction in value of the interest causes an

increase in the amount by which the amount of the right of recourse exceeds the value of the interest. The burden of proving impairment is on the party asserting discharge.

(6) If the obligation of a party is secured by an interest in collateral not provided by an accommodation party and a person entitled to enforce the instrument impairs the value of the interest in collateral, the obligation of any party who is jointly and severally liable with respect to the secured obligation is discharged to the extent the impairment causes the party asserting discharge to pay more than that party would have been obliged to pay, taking into account rights of contribution, if impairment had not occurred. If the party asserting discharge is an accommodation party not entitled to discharge under subsection (5) of this section, the party is deemed to have a right to contribution based on joint and several liability rather than a right to reimbursement. The burden of proving impairment is on the party asserting discharge.

(7) Under subsection (5) or (6) of this section, impairing value of an interest in collateral includes (i) failure to obtain or maintain perfection or recordation of the interest in collateral, (ii) release of collateral without substitution of collateral of equal value, (iii) failure to perform a duty to preserve the value of collateral owed, under chapter 9[, title 28, Idaho Code,] or other law, to a debtor or surety or other person secondarily liable, or (iv) failure to comply with applicable law in disposing of collateral.

(8) An accommodation party is not discharged under subsection (3), (4) or (5) of this section unless the person entitled to enforce the instrument knows of the accommodation or has notice under section 28-3-419(3)[, Idaho Code,] that the instrument was signed for accommodation.

(9) A party is not discharged under this section if (i) the party asserting discharge consents to the event or conduct that is the basis of the discharge, or (ii) the instrument or a separate agreement of the party provides for waiver of discharge under this section either specifically or by general language indicating that parties waive defenses based on suretyship or impairment of collateral.

History.

I.C., § 28-3-605, as added by 1993, ch. 288, § 2, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-3-605 was repealed. See Prior Laws, § 28-3-101.

Compiler's Notes.

The bracketed insertions in subsections (1), (2), (7), and (8) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Discharge of Guarantor.

Common law rule, that "satisfaction of the principal debt or a release of the principal debtor discharges the guarantor," will no longer apply to a guarantor who is deemed "an accommodation party" under this section and § 28-3-419(5). Ponderosa Paint Mfg., Inc. v. Yack, 125 Idaho 310, 870 P.2d 663 (Ct. App. 1994).

Decisions Under Prior Law

Construction.

Former law provided essentially that the holder discharges any party to the instrument to the extent that, without such party's consent and without an express reservation of rights, the holder agrees to suspend the right to enforce against such person. Kaufman v. Fairchild, 119 Idaho 859, 810 P.2d 1145 (Ct. App. 1991).

Defense Not Available.

The impairment of collateral defense is not available to a maker who has primary liability under a promissory note. First Nat'l Bank v. Burgess, 118

Idaho 627, 798 P.2d 472 (Ct. App. 1990).

Federal Rule.

Former law provided a federal rule for small business administration loan transactions in this state. Great S.W. Life Ins. Co. v. Frazier, 860 F.2d 896 (9th Cir. 1988).

Party.

A co-maker of a note cannot assert the impairment of collateral defense. Great S.W. Life Ins. Co. v. Frazier, 860 F.2d 896 (9th Cir. 1988).

Waiver.

Dealer financing agreement and secondary personal guaranties, providing that the defendant dealers and owners of dealership were indebted whether or not the bank preserved the property, functioned to waive the defendants' right to assert a defense based upon impairment of collateral. First Sec. Bank v. Mountain View Equip. Co., 112 Idaho 158, 730 P.2d 1078 (Ct. App. 1986), aff'd, 112 Idaho 1078, 739 P.2d 377 (1987).

Official Comment

1. Section 3-605, which replaces former Section 3-606, can be illustrated by an example. Bank lends $10,000 to Borrower who signs a note under which Borrower is obliged to pay $10,000 to Bank on a due date stated in the note. Bank insists, however, that Accommodation Party also become liable to pay the note. Accommodation Party can incur this liability by signing the note as a co-maker or by indorsing the note. In either case the note is signed for accommodation and Borrower is the accommodated party. Rights and obligations of Accommodation Party in this case are stated in Section 3-419. Suppose that after the note is signed, Bank agrees to a modification of the rights and obligations between Bank and Borrower. For example, Bank agrees that Borrower may pay the note at some date after the due date, or that Borrower may discharge Borrower's $10,000 obligation to pay the note by paying Bank $3,000, or that Bank releases collateral given by Borrower to secure the note. Under the law of suretyship Borrower is usually referred to as the principal debtor and Accommodation Party is referred to as the surety. Under that law, the surety can be discharged under certain circumstances if changes of this kind are made by

Bank, the creditor, without the consent of Accommodation Party, the surety. Rights of the surety to discharge in such cases are commonly referred to as suretyship defenses. Section 3-605 is concerned with this kind of problem in the context of a negotiable instrument to which the principal debtor and the surety are parties. But Section 3-605 has a wider scope. It also applies to indorsers who are not accommodation parties. Unless an indorser signs without recourse, the indorser's liability under Section 3-415(a) is that of a guarantor of payment. If Bank in our hypothetical case indorsed the note and transferred it to Second Bank, Bank has rights given to an indorser under Section 3-605 if it is Second Bank that modifies rights and obligations of Borrower. Both accommodation parties and indorsers will be referred to in these Comments as sureties. The scope of Section 3-605 is also widened by subsection (e) which deals with rights of a non-accommodation party co-maker when collateral is impaired.

2. The importance of suretyship defenses is greatly diminished by the fact that they can be waived. The waiver is usually made by a provision in the note or other writing that represents the obligation of the principal debtor. It is standard practice to include a waiver of suretyship defenses in notes given to financial institutions or other commercial creditors. Section 3-605(i) allows waiver. Thus, Section 3-605 applies to the occasional case in which the creditor did not include a waiver clause in the instrument or in which the creditor did not obtain the permission of the surety to take the action that triggers the suretyship defense.

3. Subsection (b) addresses the effect of discharge under Section 3-604 of the principal debtor. In the hypothetical case stated in Comment 1, release of Borrower by Bank does not release Accommodation Party. As a practical matter, Bank will not gratuitously release Borrower. Discharge of Borrower normally would be part of a settlement with Borrower if Borrower is insolvent or in financial difficulty. If Borrower is unable to pay all creditors, it may be prudent for Bank to take partial payment, but Borrower will normally insist on a release of the obligation. If Bank takes \$3,000 and releases Borrower from the \$10,000 debt, Accommodation Party is not injured. To the extent of the payment Accommodation Party's obligation to Bank is reduced. The release of Borrower by Bank does not affect the right of Accommodation Party to obtain reimbursement from Borrower if Accommodation Party pays Bank. Section 3-419(e). Subsection (b) is

designed to allow a creditor to settle with the principal debtor without risk of losing rights against sureties. Settlement is in the interest of sureties as well as the creditor. Subsection (b) changes the law stated in former Section 3-606 but the change relates largely to formalities rather than substance. Under former Section 3-606, Bank could settle with and release Borrower without releasing Accommodation Party, but to accomplish that result Bank had to either obtain the consent of Accommodation Party or make an express reservation of rights against Accommodation Party at the time it released Borrower. The reservation of rights was made in the agreement between Bank and Borrower by which the release of Borrower was made. There was no requirement in former Section 3-606 that any notice be given to Accommodation Party. Section 3-605 eliminates the necessity that Bank formally reserve rights against Accommodation Party in order to retain rights of recourse against Accommodation Party. See PEB Commentary No. 11, dated February 10, 1994.

4. Subsection (c) relates to extensions of the due date of the instrument. In most cases an extension of time to pay a note is a benefit to both the principal debtor and sureties having recourse against the principal debtor. In relatively few cases the extension may cause loss if deterioration of the financial condition of the principal debtor reduces the amount that the surety will be able to recover on its right of recourse when default occurs. Former Section 3-606(1)(a) did not take into account the presence or absence of loss to the surety. For example, suppose the instrument is an installment note and the principal debtor is temporarily short of funds to pay a monthly installment. The payee agrees to extend the due date of the installment for a month or two to allow the debtor to pay when funds are available. Under former Section 3-606 surety was discharged if consent was not given unless the payee expressly reserved rights against the surety. It did not matter that the extension of time was a trivial change in the guaranteed obligation and that there was no evidence that the surety suffered any loss because of the extension. *Wilmington Trust Co. v. Gesullo,* 29 U.C.C. Rep. 144 (Del. Super. Ct. 1980). Under subsection (c) an extension of time results in discharge only to the extent the surety proves that the extension caused loss. For example, if the extension is for a long period the surety might be able to prove that during the period of extension the principal debtor became insolvent, thus reducing the value of the right of recourse of the surety. By putting the burden on the surety to prove loss,

subsection (c) more accurately reflects what the parties would have done by agreement, and it facilitates workouts.

5. Former Section 3-606 applied to extensions of the due date of a note but not to other modifications of the obligation of the principal debtor. There was no apparent reason why former Section 3-606 did not follow general suretyship law in covering both. Under Section 3-605(d) a material modification of the obligation of the principal debtor, other than an extension of the due date, will result in discharge of the surety to the extent the modification caused loss to the surety with respect to the right of recourse. The loss caused by the modification is deemed to be the entire amount of the right of recourse unless the person seeking enforcement of the instrument proves that no loss occurred or that the loss was less than the full amount of the right of recourse. In the absence of that proof, the surety is completely discharged. The rationale for having different rules with respect to loss for extensions of the due date and other modifications is that extensions are likely to be beneficial to the surety and they are often made. Other modifications are less common and they may very well be detrimental to the surety. Modification of the obligation of the principal debtor without permission of the surety is unreasonable unless the modification is benign. Subsection (d) puts the burden on the person seeking enforcement of the instrument to prove the extent to which loss was not caused by the modification.

6. Subsection (e) deals with discharge of sureties by impairment of collateral. It generally conforms to former Section 3-606(1)(b). Subsection (g) states common examples of what is meant by impairment. By using the term "includes," it allows a court to find impairment in other cases as well. There is extensive case law on impairment of collateral. The surety is discharged to the extent the surety proves that impairment was caused by a person entitled to enforce the instrument. For example, suppose the payee of a secured note fails to perfect the security interest. The collateral is owned by the principal debtor who subsequently files in bankruptcy. As a result of the failure to perfect, the security interest is not enforceable in bankruptcy. If the payee obtains payment from the surety, the surety is subrogated to the payee's security interest in the collateral. In this case the value of the security interest is impaired completely because the security

interest is unenforceable. If the value of the collateral is as much or more than the amount of the note there is a complete discharge.

In some states a real property grantee who assumes the obligation of the grantor as maker of a note secured by the real property becomes by operation of law a principal debtor and the grantor becomes a surety. The meager case authority was split on whether former Section 3-606 applied to release the grantor if the holder released or extended the obligation of the grantee. Revised Article 3 takes no position on the effect of the release of the grantee in this case. Section 3-605(e) does not apply because the holder has not discharged the obligation of a "party," a term defined in Section 3-103(a)(8) as "party to an instrument." The assuming grantee is not a party to the instrument.

7. Subsection (f) is illustrated by the following case. X and Y sign a note for $1,000 as co-makers. Neither is an accommodation party. X grants a security interest in X's property to secure the note. The collateral is worth more than $1,000. Payee fails to perfect the security interest in X's property before X files in bankruptcy. As a result the security interest is not enforceable in bankruptcy. Had Payee perfected the security interest, Y could have paid the note and gained rights to X's collateral by subrogation. If the security interest had been perfected, Y could have realized on the collateral to the extent of $500 to satisfy its right of contribution against X. Payee's failure to perfect deprived Y of the benefit of the collateral. Subsection (f) discharges Y to the extent of its loss. If there are no assets in the bankruptcy for unsecured claims, the loss is $500, the amount of Y's contribution claim against X which now has a zero value. If some amount is payable on unsecured claims, the loss is reduced by the amount receivable by Y. The same result follows if Y is an accommodation party but Payee has no knowledge of the accommodation or notice under Section 3-419(c). In that event Y is not discharged under subsection (e), but subsection (f) applies because X and Y are jointly and severally liable on the note. Under subsection (f), Y is treated as a co-maker with a right of contribution rather than an accommodation party with a right of reimbursement. Y is discharged to the extent of $500. If Y is the principal debtor and X is the accommodation party subsection (f) doesn't apply. Y, as principal debtor, is not injured by the impairment of collateral because Y would have been

obliged to reimburse X for the entire $1,000 even if Payee had obtained payment from sale of the collateral.

8. Subsection (i) is a continuation of former law which allowed suretyship defenses to be waived. As the subsection provides, a party is not discharged under this section if the instrument or a separate agreement of the party waives discharge either specifically or by general language indicating that defenses based on suretyship and impairment of collateral are waived. No particular language or form of agreement is required, and the standards for enforcing such a term are the same as the standards for enforcing any other term in an instrument or agreement.

Subsection (i), however, applies only to a "discharge under this section." The right of an accommodation party to be discharged under Section 3-605(e) because of an impairment of collateral can be waived. But with respect to a note secured by personal property collateral, Title 9 also applies. If an accommodation party is a "debtor" under Section 9-105(1)(d), the accommodation party has rights under Title 9. Under Section 9-501(3)(b) rights of an Title 9 debtor under Section 9-504(3) and Section 9-505(1), which deal with disposition of collateral, cannot be waived except as provided in Title 9. These Title 9 rights are independent of rights under Section 3-605. Since Section 3-605(i) is specifically limited to discharge under Section 3-605, a waiver of rights with respect to Section 3-605 has no effect on rights under Title 9. With respect to Title 9 rights, Section 9-501(3)(b) controls. See PEB Commentary No. 11, dated February 10, 1994.

§ 28-3-606. Impairment of recourse or of collateral. [Repealed.]

STATUTORY NOTES

Prior Laws.

Former § 28-3-606 was repealed. See Prior Laws, § 28-3-101.

Part 7
Advice of International Sight Draft

Idaho Code § 28-3-701

§ 28-3-701. Letter of advice of international sight draft. [Repealed.]

STATUTORY NOTES

Prior Laws.

Former § 28-3-701 was repealed. See Prior Laws, § 28-3-101.

Part 8
Miscellaneous

§ 28-3-801 — 28-3-805. Drafts in set — Effect of instrument on obligation for which it is given — Notice to third party — Lost, destroyed or stolen instruments — Instruments not payable to order or to bearer. [Repealed.]

STATUTORY NOTES

Prior Laws.

Former §§ 28-3-801 — 28-3-805 were repealed. See Prior Laws, § 28-3-101.

Chapter 4
UNIFORM COMMERCIAL CODE — BANK DEPOSITS AND COLLECTIONS

Part 1. General Provisions and Definitions

Part 2. Collection of Items — Depositary and Collecting Banks

Part 3. Collection of Items — Payor Banks

Part 4. Relationship Between Payor Bank and Its Customer

Part 5. Collection of Documentary Drafts

Part 6. Funds Transfers Subject Matter and Definitions

Issue and Acceptance of Payment Order

Execution of Sender's Payment Order By Receiving Bank

Payment

Miscellaneous Provisions

Part 1
General Provisions and Definitions

§ 28-4-101. Short title. — This chapter may be cited as Uniform Commercial Code — Bank Deposits and Collections.

History.

1967, ch. 161, § 4-101, p. 351; am. 1993, ch. 288, § 3, p. 1019.

STATUTORY NOTES

Compiler's Notes.

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Section 54 of S.L. 1993, ch. 288 read: "Rights and obligations that arose under Chapter 6, Title 28, Idaho Code, and Section 28-9-111, Idaho Code, before their repeal remain valid and may be enforced as though those statutes had not been repealed."

RESEARCH REFERENCES

C.J.S. — 9 C.J.S., Banks and Banking, § 328 et seq.

ALR. — Bank's right to apply or set off deposit against debt of depositor not due at time of his death. 7 A.L.R.3d 908.

Construction and effect of UCC Art. 4, dealing with bank deposits and collections. 18 A.L.R.3d 1376.

Right of bank certifying check or note by mistake to cancel, or avoid effect of, certification. 25 A.L.R.3d 1367.

Bank's liability to nonsigning payee for payment of check drawn to joint payees without obtaining endorsement by both. 47 A.L.R.3d 537.

Power of savings bank or similar institution to provide checking facilities or negotiable orders of withdrawal (NOW) to customers. 64 A.L.R.3d 1314.

Existence of fiduciary relationship between bank and depositor or customer so as to impose special duty of disclosure upon bank. 70 A.L.R.3d 1344.

Uniform Commercial Code: bank's right to stop payment on its own uncertified check or money order. 97 A.L.R.3d 714.

Construction and effect of UCC §§ 4-301 and 4-302 making payor bank accountable for failure to act promptly on item presented for payment. 22 A.L.R.4th 10.

Construction and application of UCC § 4-205(1) allowing depositary bank to supply customer's indorsement on item for collection. 29 A.L.R.4th 631.

Extent of bank's liability for paying postdated check. 31 A.L.R.4th 329.

What constitutes wrongful dishonor of check rendering payor bank liable to drawer under UCC § 4-402. 88 A.L.R.4th 568.

Who may recover for wrongful dishonor of check under UCC § 4-402. 88 A.L.R.4th 613.

Damages recoverable for wrongful dishonor of check under UCC § 4-402. 88 A.L.R.4th 644.

Official Comment

1. The great number of checks handled by banks and the country-wide nature of the bank collection process require uniformity in the law of bank collections. There is needed a uniform statement of the principal rules of the bank collection process with ample provision for flexibility to meet the needs of the large volume handled and the changing needs and conditions that are bound to come with the years. This Article meets that need.

2. In 1950 at the time Article 4 was drafted, 6.7 billion checks were written annually. By the time of the 1990 revision of Article 4 annual volume was estimated by the American Bankers Association to be about 50 billion checks. The banking system could not have coped with this increase

in check volume had it not developed in the late 1950s and early 1960s an automated system for check collection based on encoding checks with machine-readable information by Magnetic Ink Character Recognition (MICR). An important goal of the 1990 revision of Article 4 is to promote the efficiency of the check collection process by making the provisions of Article 4 more compatible with the needs of an automated system and, by doing so, increase the speed and lower the cost of check collection for those who write and receive checks. An additional goal of the 1990 revision of Article 4 is to remove any statutory barriers in the Article to the ultimate adoption of programs allowing the presentment of checks to payor banks by electronic transmission of information captured from the MICR line on the checks. The potential of these programs for saving the time and expense of transporting the huge volume of checks from depositary to payor banks is evident.

3. Article 4 defines rights between parties with respect to bank deposits and collections. It is not a regulatory statute. It does not regulate the terms of the bank-customer agreement, nor does it prescribe what constraints different jurisdictions may wish to impose on that relationship in the interest of consumer protection. The revisions in Article 4 are intended to create a legal framework that accommodates automation and truncation for the benefit of all bank customers. This may raise consumer problems which enacting jurisdictions may wish to address in individual legislation. For example, with respect to Section 4-401(c), jurisdictions may wish to examine their unfair and deceptive practices laws to determine whether they are adequate to protect drawers who postdate checks from unscrupulous practices that may arise on the part of persons who induce drawers to issue postdated checks in the erroneous belief that the checks will not be immediately payable. Another example arises from the fact that under various truncation plans customers will no longer receive their cancelled checks and will no longer have the cancelled check to prove payment. Individual legislation might provide that a copy of a bank statement along with a copy of the check is prima facie evidence of payment.

§ 28-4-102. Applicability. — (1) To the extent that items within this chapter are also within chapters 3 and 8[, title 28, Idaho Code], they are subject to the provisions of those chapters. If there is conflict, the provisions of this chapter govern those of chapter 3[, title 28, Idaho Code], but the provisions of chapter 8[, title 28, Idaho Code,] govern those of this chapter.

(2) The liability of a bank for action or nonaction with respect to an item handled by it for purposes of presentment, payment or collection is governed by the law of the place where the bank is located. In the case of action or nonaction by or at a branch or separate office of a bank, its liability is governed by the law of the place where the branch or separate office is located.

History.

1967, ch. 161, § 4-102, p. 351; am. 1993, ch. 288, § 4, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (1) were added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Idaho Law Review. — Choice of Law in Idaho: A Survey and Critique of Idaho Cases, Andrew S. Jorgensen. 49 Idaho L. Rev. 547 (2013).

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 11.

Official Comment

1. The rules of Article [chapter] 3 governing negotiable instruments, their transfer, and the contracts of the parties thereto apply to the items collected through banking channels wherever no specific provision is found in this

Article. In the case of conflict, this Article [chapter] governs. See Section 3-102(b) [§ 28-3-102(2)].

Bonds and like instruments constituting investment securities under Article [chapter] 8 may also be handled by banks for collection purposes. Various sections of Article [chapter] 8 prescribe rules of transfer some of which (see Sections 8-108 and 8-304) may conflict with provisions of this Article [chapter] (Sections 4-205, 4-207, and 4-208). In the case of conflict, Article [chapter] 8 governs.

Section 4-210 deals specifically with overlapping problems and possible conflicts between this Article [chapter] and Article [chapter] 9. However, similar reconciling provisions are not necessary in the case of Articles [chapters] 5 and 7. Sections 4-301 and 4-302 are consistent with Section 5-112. In the case of Article [chapter] 7 documents of title frequently accompany items but they are not themselves items. See Section 4-104(a)(9) [§ 28-4-104(1)(i)].

In *Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943), the Court held that if the United States is a party to an instrument, its rights and duties are governed by federal common law in the absence of a specific federal statute or regulation. In *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), the Court stated a three-pronged test to ascertain whether the federal common-law rule should follow the state rule. In most instances courts under the *Kimbell* test have shown a willingness to adopt UCC rules in formulating federal common law on the subject. In *Kimbell* the Court adopted the priorities rules of Article [chapter] 9.

In addition, applicable federal law may supersede provisions of this Article [chapter]. One federal law that does so is the Expedited Funds Availability Act, 12 U.S.C. § 4001 et seq., and its implementing Regulation CC, 12 CFR Pt. 229. In some instances this law is alluded to in the statute, e.g., Section 4-215(e) and (f). In other instances, although not referred to in this Article, the provisions of the EFAA and Regulation CC control with respect to checks. For example, except between the depositary bank and its customer, all settlements are final and not provisional (Regulation CC, Section 229.36(d)), and the midnight deadline may be extended (Regulation CC, Section 229.30(c)). The Comments to this Article suggest in most instances the relevant Regulation CC provisions.

2. Subsection (b) [(2)] is designed to state a workable rule for the solution of otherwise vexatious problems of the conflicts of laws:

a. The routine and mechanical nature of bank collections makes it imperative that one law govern the activities of one office of a bank. The requirement found in some cases that to hold an indorser notice must be given in accordance with the law of the place of indorsement, since that method of notice became an implied term of the indorser's contract, is more theoretical than practical.

b. Adoption of what is in essence a tort theory of the conflict of laws is consistent with the general theory of this Article that the basic duty of a collecting bank is one of good faith and the exercise of ordinary care. Justification lies in the fact that, in using an ambulatory instrument, the drawer, payee, and indorsers must know that action will be taken with respect to it in other jurisdictions. This is especially pertinent with respect to the law of the place of payment.

c. The phrase "action or nonaction with respect to any item handled by it for purposes of presentment, payment, or collection" is intended to make the conflicts rule of subsection (b)[(2)] apply from the inception of the collection process of an item through all phases of deposit, forwarding, presentment, payment and remittance or credit of proceeds. Specifically the subsection applies to the initial act of a depositary bank in receiving an item and to the incidents of such receipt. The conflicts rule of *Weissman v. Banque de Bruxelles*, 254 N.Y. 488, 173 N.E. 835 (1930), is rejected. The subsection applies to questions of possible vicarious liability of a bank for action or nonaction of sub-agents (see Section 4-202(c) [§ 28-4-202(3)]), and tests these questions by the law of the state of the location of the bank which uses the sub-agent. The conflicts rule of *St. Nicholas Bank of New York v. State Nat. Bank*, 128 N.Y. 26, 27 N.E. 849, 13 L.R.A. 241 (1891), is rejected. The subsection applies to action or nonaction of a payor bank in connection with handling an item (see Sections 4-215(a) [§ 28-4-215(1)], 4-301, 4-302, 4-303) as well as action or nonaction of a collecting bank (Sections 4-201 through 4-216); to action or nonaction of a bank which suspends payment or is affected by another bank suspending payment (Section 4-216); to action or nonaction of a bank with respect to an item under the rule of Part 4 of Article [chapter] 4.

d. In a case in which subsection (b) makes this Article [chapter] applicable, Section 4-103(a) [§ 28-4-103(1)] leaves open the possibility of an agreement with respect to applicable law. This freedom of agreement follows the general policy of Section 1-105.

§ 28-4-103. Variation by agreement — Measure of damages — Certain action constituting ordinary care. — (1) The effect of the provisions of this chapter may be varied by agreement, but the parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care, or limit the measure of damages for the lack or failure. However, the parties may determine by agreement the standards by which the bank's responsibility is to be measured if those standards are not manifestly unreasonable.

(2) Federal reserve regulations and operating circulars, clearinghouse rules, and the like have the effect of agreements under subsection (1) of this section, whether or not specifically assented to by all parties interested in items handled.

(3) Action or nonaction approved by this chapter or pursuant to federal reserve regulations or operating circulars is the exercise of ordinary care and, in the absence of special instructions, action or nonaction consistent with clearinghouse rules and the like or with a general banking usage not disapproved by this chapter, is prima facie the exercise of ordinary care.

(4) The specification or approval of certain procedures by this chapter is not disapproval of other procedures that may be reasonable under the circumstances.

(5) The measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount that could not have been realized by the exercise of ordinary care. If there is also bad faith it includes any other damages the party suffered as a proximate consequence.

History.

1967, ch. 161, § 4-103, p. 351; am. 1993, ch. 288, § 5, p. 1019.

CASE NOTES

Liability of Drawee Bank.

Where the evidence, in an action by a corporate depositor against the drawee bank to have the corporation's account credited for forged checks paid by the bank, supported the finding that the depositor was not negligent in contributing to the forgeries, the drawee bank was liable to the depositor for amounts paid on the checks which were forged by manually tracing a facsimile signature from another corporate check, even though the corporation had authorized the bank to pay checks which were impressed with a facsimile signature, because placing a traced signature on the checks was not the same as mechanically impressing the signature on the checks. Mercantile Stores Co. v. Idaho First Nat'l Bank, 102 Idaho 820, 641 P.2d 1007 (Ct. App. 1982).

Decisions Under Prior Law

Banking Custom.

As a general proposition, every commercial contract, including those in connection with banking business, is deemed entered into with understanding that usage and custom in regard to particular matter of contract becomes part of transaction itself unless the contrary appears. Fischer v. First Nat'l Bank, 55 Idaho 251, 40 P.2d 625 (1935).

Since the statute did not specify any time for holding checks or items received from foreign correspondents, a banking custom to hold such items until close of business day upon which received was valid and reasonable. Fischer v. First Nat'l Bank, 55 Idaho 251, 40 P.2d 625 (1935).

Official Comment

1. Section 1-102 states the general principles and rules for variation of the effect of this Act by agreement and the limitations to this power. Section 4-103 states the specific rules for variation of Article 4 by agreement and also certain standards of ordinary care. In view of the technical complexity of the field of bank collections, the enormous number of items handled by banks, the certainty that there will be variations from the normal in each day's work in each bank, the certainty of changing conditions and the possibility of developing improved methods of collection to speed the process, it would be unwise to freeze present methods of operation by mandatory statutory rules. This section, therefore, permits within wide limits variation of the effect of provisions of the Article by agreement.

2. Subsection (a) confers blanket power to vary all provisions of the Article by agreements of the ordinary kind. The agreements may not disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care and may not limit the measure of damages for the lack or failure, but this subsection like Section 1-102(3) approves the practice of parties determining by agreement the standards by which the responsibility is to be measured. In the absence of a showing that the standards manifestly are unreasonable, the agreement controls. Owners of items and other interested parties are not affected by agreements under this subsection unless they are parties to the agreement or are bound by adoption, ratification, estoppel or the like.

As here used "agreement" has the meaning given to it by Section 1-201(3). The agreement may be direct, as between the owner and the depositary bank; or indirect, as in the case in which the owner authorizes a particular type of procedure and any bank in the collection chain acts pursuant to such authorization. It may be with respect to a single item; or to all items handled for a particular customer, e.g., a general agreement between the depositary bank and the customer at the time a deposit account is opened. Legends on deposit tickets, collection letters and acknowledgments of items, coupled with action by the affected party constituting acceptance, adoption, ratification, estoppel or the like, are agreements if they meet the tests of the definition of "agreement." See Section 1-201(3). *First Nat. Bank of Denver v. Federal Reserve Bank*, 6 F.2d 339 (8th Cir. 1925) (deposit slip); *Jefferson County Bldg. Ass'n v. Southern Bank & Trust Co.*, 225 Ala. 25, 142 So. 66 (1932) (signature card and deposit slip); *Semingson v. Stock Yards Nat. Bank*, 162 Minn. 424, 203 N.W. 412 (1925) (passbook); *Farmers State Bank v. Union Nat. Bank*, 42 N.D. 449, 454, 173 N.W. 789, 790 (1919) (acknowledgment of receipt of item).

3. Subsection (a) (subject to its limitations with respect to good faith and ordinary care) goes far to meet the requirements of flexibility. However, it does not by itself confer fully effective flexibility. Since it is recognized that banks handle a great number of items every business day and that the parties interested in each item include the owner of the item, the drawer (if it is a check), all nonbank indorsers, the payor bank and from one to five or more collecting banks, it is obvious that it is impossible, practically, to

obtain direct agreements from all of these parties on all items. In total, the interested parties constitute virtually every adult person and business organization in the United States. On the other hand they may become bound to agreements on the principle that collecting banks acting as agents have authority to make binding agreements with respect to items being handled. This conclusion was assumed but was not flatly decided in *Federal Reserve Bank of Richmond v. Malloy*, 264 U.S. 160, at 167, 44 S. Ct. 296, at 298, 68 L. Ed. 617, 31 A.L.R. 1261 (1924).

To meet this problem subsection (b) provides that official or quasi-official rules of collection, that is Federal Reserve regulations and operating circulars, clearinghouse rules, and the like, have the effect of agreements under subsection (a), whether or not specifically assented to by all parties interested in items handled. Consequently, such official or quasi-official rules may, standing by themselves but subject to the good faith and ordinary care limitations, vary the effect of the provisions of Article 4.

Federal Reserve regulations . Various sections of the Federal Reserve Act (12 U.S.C. § 221 et seq.) authorize the Board of Governors of the Federal Reserve System to direct the Federal Reserve banks to exercise bank collection functions. For example, Section 16 (12 U.S.C. § 248(o)) authorizes the Board to require each Federal Reserve bank to exercise the functions of a clearing house for its members and Section 13 (12 U.S.C. § 342) authorizes each Federal Reserve bank to receive deposits from nonmember banks solely for the purposes of exchange or of collection. Under this statutory authorization the Board has issued Regulation J (Subpart A — Collection of Checks and Other Items). Under the supremacy clause of the Constitution, federal regulations prevail over state statutes. Moreover, the Expedited Funds Availability Act, 12 U.S.C. Section 4007(b) provides that the Act and Regulation CC, 12 CFR 229, supersede "any provision of the law of any State, including the Uniform Commercial Code as in effect in such State, which is inconsistent with this chapter or such regulations." See Comment 1 to Section 4-102.

Federal Reserve operating circulars. The regulations of the Federal Reserve Board authorize the Federal Reserve banks to promulgate operating circulars covering operating details. Regulation J, for example, provides that "Each Reserve Bank shall receive and handle items in accordance with this subpart, and shall issue operating circulars governing the details of its

handling of items and other matters deemed appropriate by the Reserve Bank." This Article recognizes that "operating circulars" issued pursuant to the regulations and concerned with operating details as appropriate may, within their proper sphere, vary the effect of the Article.

ClearingHouse Rules. Local clearinghouses have long issued rules governing the details of clearing; hours of clearing, media of remittance, time for return of missent items and the like. The case law has recognized these rules, within their proper sphere, as binding on affected parties and as appropriate sources for the courts to look to in filling out details of bank collection law. Subsection (b) in recognizing clearinghouse rules as a means of preserving flexibility continues the sensible approach indicated in the cases. Included in the term "clearing houses" are county and regional clearing houses as well as those within a single city or town. There is, of course, no intention of authorizing a local clearing house or a group of clearing houses to rewrite the basic law generally. The term "clearinghouse rules" should be understood in the light of functions the clearing houses have exercised in the past.

And the like. This phrase is to be construed in the light of the foregoing. "Federal Reserve regulations and operating circulars" cover rules and regulations issued by public or quasi-public agencies under statutory authority. "Clearinghouse rules" cover rules issued by a group of banks which have associated themselves to perform through a clearing house some of their collection, payment and clearing functions. Other agencies or associations of this kind may be established in the future whose rules and regulations could be appropriately looked on as constituting means of avoiding absolute statutory rigidity. The phrase "and the like" leaves open possibilities for future development. An agreement between a number of banks or even all the banks in an area simply because they are banks, would not of itself, by virtue of the phrase "and the like," meet the purposes and objectives of subsection (b).

4. Under this Article banks come under the general obligations of the use of good faith and the exercise of ordinary care. "Good faith" is defined in Section 3-103(a)(4). The term "ordinary care" is defined in Section 3-103(a)(7). These definitions are made to apply to Article 4 by Section 4-104(c). Section 4-202 states respects in which collecting banks must use ordinary care. Subsection (c) of Section 4-103 provides that action or nonaction

approved by the Article or pursuant to Federal Reserve regulations or operating circulars constitutes the exercise of ordinary care. Federal Reserve regulations and operating circulars constitute an affirmative standard of ordinary care equally with the provisions of Article 4 itself.

Subsection (c) further provides that, absent special instructions, action or nonaction consistent with clearinghouse rules and the like or with a general banking usage not disapproved by the Article, prima facie constitutes the exercise of ordinary care. Clearinghouse rules and the phrase "and the like" have the significance set forth above in these Comments. The term "general banking usage" is not defined but should be taken to mean a general usage common to banks in the area concerned. See Section 1-205 [1-303] (2). In a case in which the adjective "general" is used, the intention is to require a usage broader than a mere practice between two or three banks but it is not intended to require anything as broad as a country-wide usage. A usage followed generally throughout a state, a substantial portion of a state, a metropolitan area or the like would certainly be sufficient. Consistently with the principle of Section 1-205 [1-303] (3), action or nonaction consistent with clearinghouse rules or the like or with banking usages prima facie constitutes the exercise of ordinary care. However, the phrase "in the absence of special instructions" affords owners of items an opportunity to prescribe other standards and although there may be no direct supervision or control of clearing houses or banking usages by official supervisory authorities, the confirmation of ordinary care by compliance with these standards is prima facie only, thus conferring on the courts the ultimate power to determine ordinary care in any case in which it should appear desirable to do so. The prima facie rule does, however, impose on the party contesting the standards to establish that they are unreasonable, arbitrary or unfair as used by the particular bank.

5. Subsection (d), in line with the flexible approach required for the bank collection process is designed to make clear that a novel procedure adopted by a bank is not to be considered unreasonable merely because that procedure is not specifically contemplated by this Article or by agreement, or because it has not yet been generally accepted as a bank usage. Changing conditions constantly call for new procedures and someone has to use the new procedure first. If this procedure is found to be reasonable under the circumstances, provided, of course, that it is not inconsistent with any

provision of the Article or other law or agreement, the bank which has followed the new procedure should not be found to have failed in the exercise of ordinary care.

6. Subsection (e) sets forth a rule for determining the measure of damages for failure to exercise ordinary care which, under subsection (a), cannot be limited by agreement. In the absence of bad faith the maximum recovery is the amount of the item concerned. The term "bad faith" is not defined; the connotation is the absence of good faith (Section 3-103). When it is established that some part or all of the item could not have been collected even by the use of ordinary care the recovery is reduced by the amount that would have been in any event uncollectible. This limitation on recovery follows the case law. Finally, if bad faith is established the rule opens to allow the recovery of other damages, whose "proximateness" is to be tested by the ordinary rules applied in comparable cases. Of course, it continues to be as necessary under subsection (e) as it has been under ordinary common law principles that, before the damage rule of the subsection becomes operative, liability of the bank and some loss to the customer or owner must be established.

§ 28-4-104. Definitions and index of definitions. — (1) In this chapter, unless the context otherwise requires:

(a) "Account" means any deposit or credit account with a bank, including a demand, time, savings, passbook, share draft, or like account, other than an account evidenced by a certificate of deposit; (b) "Afternoon" means the period of a day between noon and midnight; (c) "Banking day" means the part of a day on which a bank is open to the public for carrying on substantially all of its banking functions; (d) "Clearing house" means an association of banks or other payors regularly clearing items; (e) "Customer" means any person having an account with a bank or for whom a bank has agreed to collect items, including a bank that maintains an account at another bank; (f) "Documentary draft" means a draft to be presented for acceptance or payment if specified documents, certificated securities (section 28-8-102[, Idaho Code]) or instructions for uncertificated securities (section 28-8-102[, Idaho Code]), or other certificates, statements, or the like are to be received by the drawee or other payor before acceptance or payment of the draft; (g) "Draft" means a draft as defined in section 28-3-104[, Idaho Code,] or an item, other than an instrument, that is an order; (h) "Drawee" means a person ordered in a draft to make payment; (i) "Item" means an instrument or a promise or order to pay money handled by a bank for collection or payment. The term does not include a payment order governed by part 6 of chapter 4[, title 28, Idaho Code,] or a credit or debit card slip; (j) "Midnight deadline" with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later; (k) "Settle" means to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final; (*l*) "Suspends payments" with respect to a bank means that it has been closed by order of the supervisory authorities, that a public officer has been appointed to take it over or that it ceases or refuses to make payments in the ordinary course of business.

(2) Other definitions applying to this chapter and the sections in which they appear are: “Agreement for electronic

presentment” Section 28-4-110[, Idaho Code].

“Bank” Section 28-4-105[, Idaho Code].

“Collecting bank” Section 28-4-105[, Idaho Code].

“Depositary bank” Section 28-4-105[, Idaho Code].

“Intermediary bank” Section 28-4-105[, Idaho Code].

“Payor bank” Section 28-4-105[, Idaho Code].

“Presenting bank” Section 28-4-105[, Idaho Code].

“Presentment notice” Section 28-4-110[, Idaho Code].

(3) “Control” as provided in section 28-7-106[, Idaho Code,] and the following definitions in other chapters apply to this chapter: “Acceptance” Section 28-3-409[, Idaho Code].

“Alteration” Section 28-3-407[, Idaho Code].

“Cashier’s check” Section 28-3-104[, Idaho Code].

“Certificate of deposit” Section 28-3-104[, Idaho Code].

“Certified check” Section 28-3-409[, Idaho Code].

“Check” Section 28-3-104[, Idaho Code].

“Draft” Section 28-3-104[, Idaho Code].

“Good faith” Section 28-3-103[, Idaho Code].

“Holder in due course” Section 28-3-302[, Idaho Code].

“Instrument” Section 28-3-104[, Idaho Code].

“Notice of dishonor” Section 28-3-503[, Idaho Code].

“Order” Section 28-3-103[, Idaho Code].

“Ordinary care” Section 28-3-103[, Idaho Code].

“Person entitled to enforce” Section 28-3-301[, Idaho Code].

“Presentment” Section 28-3-501[, Idaho Code].

"Promise" Section 28-3-103[, Idaho Code].

"Prove" Section 28-3-103[, Idaho Code].

"Teller's check" Section 28-3-104[, Idaho Code].

"Unauthorized signature" Section 28-3-403[, Idaho Code].

(4) In addition chapter 1 of this title contains general definitions and principles of construction and interpretation applicable throughout this chapter.

History.

1967, ch. 161, § 4-104, p. 351; am. 1993, ch. 288, § 6, p. 1019; am. 1995, ch. 272, § 18, p. 873; am. 2004, ch. 42, § 18, p. 77.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions throughout this section were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Revocation of Signatory Authority.

The revocation of authority to execute checks was not a countermand to a previous payment order and, therefore, not a stop payment order; thus, bank did not lack good faith in honoring check written by former employee of depositor corporation, where depositor's only request was that bank strike the signature of an officer from corporation's checking account signature card. First Piedmont Bank & Trust Co. v. Doyle, 97 Idaho 700, 551 P.2d 1336 (1976), overruled on other grounds, Yacht Club Sales & Serv. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

Cited Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 318 et seq.

Official Comment

1. Paragraph (a)(1): "Account" is defined to include both asset accounts in which a customer has deposited money and accounts from which a customer may draw on a line of credit. The limiting factor is that the account must be in a bank.

2. Paragraph (a)(3): "Banking day." Under this definition that part of a business day when a bank is open only for limited functions, e.g., to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is not part of a banking day.

3. Paragraph (a)(4): "Clearing house." Occasionally express companies, governmental agencies and other nonbanks deal directly with a clearing house; hence the definition does not limit the term to an association of banks.

4. Paragraph (a)(5): "Customer." It is to be noted that this term includes a bank carrying an account with another bank as well as the more typical nonbank customer or depositor.

5. Paragraph (a)(6): "Documentary draft" applies even though the documents do not accompany the draft but are to be received by the drawee or other payor before acceptance or payment of the draft. Documents may be either in electronic or tangible form. See Article 5, Section 5-102, Comment 2 and Article 1, Section 1-201 (definition of "document of title").

6. Paragraph (a)(7): "Draft" is defined in Section 3-104 as a form of instrument. Since Article 4 applies to items that may not fall within the definition of instrument, the term is defined here to include an item that is a written order to pay money, even though the item may not qualify as an instrument. The term "order" is defined in Section 3-103.

7. Paragraph (a)(8): "Drawee" is defined in Section 3-103 in terms of an Article 3 draft which is a form of instrument. Here "drawee" is defined in terms of an Article 4 draft which includes items that may not be instruments.

8. Paragraph (a)(9): "Item" is defined broadly to include an instrument, as defined in Section 3-104, as well as promises or orders that may not be within the definition of "instrument." The terms "promise" and "order" are defined in Section 3-103. A promise is a written undertaking to pay money. An order is a written instruction to pay money. But see Section 4-110(c). Since bonds and other investment securities under Article 8 may be within the term "instrument" or "promise," they are items and when handled by banks for collection are subject to this Article. See Comment 1 to Section 4-102. The functional limitation on the meaning of this term is the willingness of the banking system to handle the instrument, undertaking or instruction for collection or payment.

9. Paragraph (a)(10): "Midnight deadline." The use of this phrase is an example of the more mechanical approach used in this Article. Midnight is selected as a termination point or time limit to obtain greater uniformity and definiteness than would be possible from other possible terminating points, such as the close of the banking day or business day.

10. Paragraph (a)(11): The term "settle" has substantial importance throughout Article 4. In the American Bankers Association Bank Collection Code, in deferred posting statutes, in Federal Reserve regulations and operating circulars, in clearing-house rules, in agreements between banks and customers and in legends on deposit tickets and collection letters, there is repeated reference to "conditional" or "provisional" credits or payments. Tied in with this concept of credits or payments being in some way tentative, has been a related but somewhat different problem as to when an item is "paid" or "finally paid" either to determine the relative priority of the item as against attachments, stop-payment orders and the like or in insolvency situations. There has been extensive litigation in the various states on these problems. To a substantial extent the confusion, the litigation and even the resulting court decisions fail to take into account that in the collection process some debits or credits are provisional or tentative and others are final and that very many debits or credits are provisional or tentative for awhile but later become final. Similarly, some cases fail to recognize that within a single bank, particularly a payor bank, each item goes through a series of processes and that in a payor bank most of these processes are preliminary to the basic act of payment or "final payment."

The term “settle” is used as a convenient term to characterize a broad variety of conditional, provisional, tentative and also final payments of items. Such a comprehensive term is needed because it is frequently difficult or unnecessary to determine whether a particular action is tentative or final or when a particular credit shifts from the tentative class to the final class. Therefore, its use throughout the Article indicates that in that particular context it is unnecessary or unwise to determine whether the debit or the credit or the payment is tentative or final. However, if qualified by the adjective “provisional” its tentative nature is intended, and if qualified by the adjective “final” its permanent nature is intended.

Examples of the various types of settlement contemplated by the term include payments in cash; the efficient but somewhat complicated process of payment through the adjustment and offsetting of balances through clearing houses; debit or credit entries in accounts between banks; the forwarding of various types of remittance instruments, sometimes to cover a particular item but more frequently to cover an entire group of items received on a particular day.

11. Paragraph (a)(12): “Suspends payments.” This term is designed to afford an objective test to determine when a bank is no longer operating as a part of the banking system.

§ 28-4-105. "Bank" — "Depositary bank" — "Intermediary bank" — "Collecting bank" — "Payor bank" — "Presenting bank." — In this chapter:

(1) "Bank" means a person engaged in the business of banking, including a savings bank, savings and loan association, credit union or trust company;

(2) "Depositary bank" means the first bank to take an item even though it is also the payor bank, unless the item is presented for immediate payment over the counter;

(3) "Payor bank" means a bank that is the drawee of a draft;

(4) "Intermediary bank" means a bank to which an item is transferred in course of collection except the depositary or payor bank;

(5) "Collecting bank" means a bank handling the item for collection except the payor bank;

(6) "Presenting bank" means a bank presenting an item except a payor bank.

History.

1967, ch. 161, § 4-105, p. 351; am. 1993, ch. 288, § 7, p. 1019.

CASE NOTES

Cited Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 68 et seq.

ALR. — Construction of UCC § 4-105, which defines "payor bank," "collecting bank," and the like. 84 A.L.R.3d 1073.

Official Comment

1. The definitions in general exclude a bank to which an item is issued, as this bank does not take by transfer except in the particular case covered in which the item is issued to a payee for collection, as in the case in which a corporation is transferring balances from one account to another. Thus, the definition of "depositary bank" does not include the bank to which a check is made payable if a check is given in payment of a mortgage. This bank has the status of a payee under Article 3 on Negotiable Instruments and not that of a collecting bank.

2. Paragraph (1): "Bank" is defined in Section 1-201(4) as meaning "any person engaged in the business of banking." The definition in paragraph (1) makes clear that "bank" includes savings banks, savings and loan associations, credit unions and trust companies, in addition to the commercial banks commonly denoted by use of the term "bank."

3. Paragraph (2): A bank that takes an "on us" item for collection, for application to a customer's loan, or first handles the item for other reasons is a depositary bank even though it is also the payor bank. However, if the holder presents the item for immediate payment over the counter, the payor bank is not a depositary bank.

4. Paragraph (3): The definition of "payor bank" is clarified by use of the term "drawee." That term is defined in Section 4-104 as meaning "a person ordered in a draft to make payment." An "order" is defined in Section 3-103 as meaning "a written instruction to pay money . . .. An authorization to pay is not an order unless the person authorized to pay is also instructed to pay." The definition of order is incorporated into Article 4 by Section 4-104(c). Thus a payor bank is one instructed to pay in the item. A bank does not become a payor bank by being merely authorized to pay or by being given an instruction to pay not contained in the item.

5. Paragraph (4): The term "intermediary bank" includes the last bank in the collection process if the drawee is not a bank. Usually the last bank is also a presenting bank.

§ 28-4-106. Payable through or payable at bank — Collecting bank. —

(1) If an item states that it is "payable through" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

(2) If an item states that it is "payable at" a bank identified in the item, (i) the item designates the bank as a collecting bank and does not by itself authorize the bank to pay the item, and (ii) the item may be presented for payment only by or through the bank.

(3) If a draft names a nonbank drawee and it is unclear whether a bank named in the draft is a codrawee or a collecting bank, the bank is a collecting bank.

History.

I.C., § 28-4-106, as added by 1993, ch. 288, § 8, p. 1019.

STATUTORY NOTES

Compiler's Notes.

Former § 28-4-106 was amended and redesignated as § 28-4-107 by § 9 of S.L. 1993, ch. 288.

Official Comment

1. This section replaces former Sections 3-120 and 3-121. Some items are made "payable through" a particular bank. Subsection (a) states that such language makes the bank a collecting bank and not a payor bank. An item identifying a "payable through" bank can be presented for payment to the drawee only by the "payable through" bank. The item cannot be presented to the drawee over the counter for immediate payment or by a collecting bank other than the "payable through" bank.

2. Subsection (b) retains the alternative approach of the present law. Under Alternative A a note payable at a bank is the equivalent of a draft drawn on the bank and the midnight deadline provisions of Sections 4-301

and 4-302 apply. Under Alternative B a "payable at" bank is in the same position as a "payable through" bank under subsection (a).

3. Subsection (c) rejects the view of some cases that a bank named below the name of a drawee is itself a drawee. The commercial understanding is that this bank is a collecting bank and is not accountable under Section 4-302 for holding an item beyond its deadline. The liability of the bank is governed by Sections 4-202(a) and 4-103(e).

§ 28-4-107. Separate office of a bank. — A branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders must be given under this chapter and under chapter 3[, title 28, Idaho Code].

History.

1967, ch. 161, § 4-106, p. 351; am. and redesig. 1993, ch. 288, § 9, p. 1019.

STATUTORY NOTES

Compiler's Notes.

This section was formerly compiled as § 28-4-106.

Former § 28-4-107 was amended and redesignated as § 28-4-108 by § 10 of S.L. 1993, ch. 288.

The bracketed insertion at the end of the section was added by the compiler to conform to the statutory citation style.

CASE NOTES

Construction.

The effect of this section, is to give a branch bank that is a payor bank its own midnight deadline for carrying out its duties as a payor, even if it keeps no "deposit ledgers" or similar books. Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

Purpose.

Although a data processing center performs some of the routine accounting steps for more than one branch, this does not destroy the essential character of the transaction: that the one branch acted as a

collecting and presenting bank for an item only another office could pay, and the legislature has expressly stated in this section its intent that the separateness of branch banks be respected in computing the midnight deadline, even where some of the branch's duties are performed outside the branch. Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

The deletion of the phrase "maintaining its own deposit ledgers," from this section, reflects that the legislature recognized that under modern, computerized branch banking — particularly in a rural state with many but widely separated branch banks — individual branches might not keep what might be characterized as "deposit ledgers," and the legislature apparently intended that, insofar as computing the time necessary to perform certain functions, a branch should not lose its identity as a separate bank merely because it combines mechanical bookkeeping procedures with other branches and has them performed at a central location. Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

Official Comment

1. A rule with respect to the status of a branch or separate office of a bank as a part of any statute on bank collections is highly desirable if not absolutely necessary. However, practices in the operations of branches and separate offices vary substantially in the different states and it has not been possible to find any single rule that is logically correct, fair in all situations and workable under all different types of practices. The decision not to draft the section with greater specificity leaves to the courts the resolution of the issues arising under this section on the basis of the facts of each case.

2. In many states and for many purposes a branch or separate office of the bank should be treated as a separate bank. Many branches function as separate banks in the handling and payment of items and require time for doing so similar to that of a separate bank. This is particularly true if branch banking is permitted throughout a state or in different towns and cities. Similarly, if there is this separate functioning a particular branch or separate office is the only proper place for various types of action to be taken or orders or notices to be given. Examples include the drawing of a check on a particular branch by a customer whose account is carried at that branch; the

presentment of that same check at that branch; the issuance of an order to the branch to stop payment on the check.

3. Section 1 of the American Bankers Association Bank Collection Code provided simply: "A branch or office of any such bank shall be deemed a bank." Although this rule appears to be brief and simple, as applied to particular sections of the ABA Code it produces illogical and, in some cases, unreasonable results. For example, under Section 11 of the ABA Code it seems anomalous for one branch of a bank to have charged an item to the account of the drawer and another branch to have the power to elect to treat the item as dishonored. Similar logical problems would flow from applying the same rule to Article 4. Warranties by one branch to another branch under Sections 4-207 and 4-208 (each considered a separate bank) do not make sense.

4. Assuming that it is not desirable to make each branch a separate bank for all purposes, this section provides that a branch or separate office is a separate bank for certain purposes. In so doing the single legal entity of the bank as a whole is preserved, thereby carrying with it the liability of the institution as a whole on such obligations as it may be under. On the other hand, in cases in which the Article provides a number of time limits for different types of action by banks, if a branch functions as a separate bank, it should have the time limits available to a separate bank. Similarly if in its relations to customers a branch functions as a separate bank, notices and orders with respect to accounts of customers of the branch should be given at the branch. For example, whether a branch has notice sufficient to affect its status as a holder in due course of an item taken by it should depend upon what notice that branch has received with respect to the item. Similarly the receipt of a stop-payment order at one branch should not be notice to another branch so as to impair the right of the second branch to be a holder in due course of the item, although in circumstances in which ordinary care requires the communication of a notice or order to the proper branch of a bank, the notice or order would be effective at the proper branch from the time it was or should have been received. See Section 1-207(27) [now § 28-1-202].

5. The bracketed language ("maintaining its own deposit ledger") in former Section 4-106 is deleted. Today banks keep records on customer accounts by electronic data storage. This has led most banks with branches

to centralize to some degree their record keeping. The place where records are kept has little meaning if the information is electronically stored and is instantly retrievable at all branches of the bank. Hence, the inference to be drawn from the deletion of the bracketed language is that where record keeping is done is no longer an important factor in determining whether a branch is a separate bank.

§ 28-4-108. Time of receipt of items. — (1) For the purpose of allowing time to process items, prove balances and make the necessary entries on its books to determine its position for the day, a bank may fix an afternoon hour of 2 P.M. or later as a cutoff hour for the handling of money and items and the making of entries on its books.

(2) An item or deposit of money received on any day after a cutoff hour so fixed or after the close of the banking day may be treated as being received at the opening of the next banking day.

History.

1967, ch. 161, § 4-107, p. 351; am. and redesig. 1993, ch. 288, § 10, p. 1019.

STATUTORY NOTES

Compiler's Notes.

This section was formerly compiled as § 28-4-107.

Former § 28-4-108 was amended and redesignated as § 28-4-109 by § 11 of S.L. 1993, ch. 288.

CASE NOTES

Cited Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

Official Comment 1. Each of the huge volume of checks processed each day must go through a series of accounting procedures that consume time. Many banks have found it necessary to establish a cutoff hour to allow time for these procedures to be completed within the time limits imposed by Article 4. Subsection (a) approves a cutoff hour of this type provided it is not earlier than 2 P.M. Subsection (b) provides that if such a cutoff hour is fixed, items received after the cutoff hour may be treated as being received at the opening of the next banking day. If the number of items received either through the mail or over the counter

tends to taper off radically as the afternoon hours progress, a 2 P.M. cutoff hour does not involve a large portion of the items received but at the same time permits a bank using such a cutoff hour to leave its doors open later in the afternoon without forcing into the evening the completion of its settling and proving process.

2. The provision in subsection (b) that items or deposits received after the close of the banking day may be treated as received at the opening of the next banking day is important in cases in which a bank closes at twelve or one o'clock, e.g., on a Saturday, but continues to receive some items by mail or over the counter if, for example, it opens Saturday evening for the limited purpose of receiving deposits and cashing checks.

§ 28-4-109. Delays. — (1) Unless otherwise instructed, a collecting bank in a good faith effort to secure payment of a specific item drawn on a payor other than a bank and with or without the approval of any person involved, may waive, modify or extend time limits imposed or permitted by this chapter for a period not exceeding two (2) additional banking days without discharge of drawers or indorsers or liability to its transferor or a prior party.

(2) Delay by a collecting bank or payor bank beyond time limits prescribed or permitted by this chapter or by instructions is excused if (i) the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank, and (ii) the bank exercises such diligence as the circumstances require.

History.

1967, ch. 161, § 4-108, p. 351; am. and redesig. 1993, ch. 288, § 11, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-4-109, which comprised 1967, ch. 161, § 4-109, p. 351, was repealed by S.L. 1993, ch. 288, § 12, effective July 1, 1993.

Compiler's Notes.

This section was formerly compiled as § 28-4-108.

Official Comment 1. Sections 4-202(b), 4-214, 4-301, and 4-302 prescribe various time limits for the handling of items. These are the limits of time within which a bank, in fulfillment of its obligation to exercise ordinary care, must handle items entrusted to it for collection or payment. Under Section 4-103 they may be varied by agreement or by Federal Reserve regulations or operating circular, clearing-house rules, or the like. Subsection (a) permits a very limited extension of

these time limits. It authorizes a collecting bank to take additional time in attempting to collect drafts drawn on nonbank payors with or without the approval of any interested party. The right of a collecting bank to waive time limits under subsection (a) does not apply to checks. The two-day extension can only be granted in a good faith effort to secure payment and only with respect to specific items. It cannot be exercised if the customer instructs otherwise. Thus limited the escape provision should afford a limited degree of flexibility in special cases but should not interfere with the overall requirement and objective of speedy collections.

2. An extension granted under subsection (a) is without discharge of drawers or indorsers. It therefore extends the times for presentment or payment as specified in Article 3.

3. Subsection (b) is another escape clause from time limits. This clause operates not only with respect to time limits imposed by the Article itself but also time limits imposed by special instructions, by agreement or by Federal regulations or operating circulars, clearing-house rules or the like. The latter time limits are "permitted" by the Code. For example, a payor bank that fails to make timely return of a dishonored item may be accountable for the amount of the item. Subsection (b) excuses a bank from this liability when its failure to meet its midnight deadline resulted from, for example, a computer breakdown that was beyond the control of the bank, so long as the bank exercised the degree of diligence that the circumstances required. In *Port City State Bank v. American National Bank,* 486 F.2d 196 (10th Cir. 1973), the court held that a bank exercised sufficient diligence to be excused under this subsection. If delay is sought to be excused under this subsection, the bank has the burden of proof on the issue of whether it exercised "such diligence as the circumstances require." The subsection is consistent with Regulation CC, Section 229.38(e).

§ 28-4-110. Electronic presentment. — (1) "Agreement for electronic presentment" means an agreement, clearing-house rule, or federal reserve regulation or operating circular, providing that presentment of an item may be made by transmission of an image of an item or information describing the item ("presentment notice") rather than delivery of the item itself. The agreement may provide for procedures governing retention, presentment, payment, dishonor and other matters concerning items subject to the agreement.

(2) Presentment of an item pursuant to an agreement for presentment is made when the presentment notice is received.

(3) If presentment is made by presentment notice, a reference to "item" or "check" in this chapter means the presentment notice unless the context otherwise indicates.

History.

I.C., § 28-4-110, as added by 1993, ch. 288, § 13, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The words enclosed in parentheses so appeared in the law as enacted.

Official Comment

1. "An agreement for electronic presentment" refers to an agreement under which presentment may be made to a payor bank by a presentment notice rather than by presentment of the item. Under imaging technology now under development, the presentment notice might be an image of the item. The electronic presentment agreement may provide that the item may be retained by a depositary bank, other collecting bank, or even a customer of the depositary bank, or it may provide that the item will follow the presentment notice. The identifying characteristic of an electronic presentment agreement is that presentment occurs when the presentment notice is received. "An agreement for electronic presentment" does not refer

to the common case of retention of items by payor banks because the item itself is presented to the payor bank in these cases. Payor bank check retention is a matter of agreement between payor banks and their customers. Provisions on payor bank check retention are found in Section 4-406(b).

2. The assumptions under which the electronic presentment amendments are based are as follows: No bank will participate in an electronic presentment program without an agreement. These agreements may be either bilateral (Section 4-103(a)/t), under which two banks that frequently do business with each other may agree to depositary bank check retention, or multilateral (Section 4-103(b)/t), in which large segments of the banking industry may participate in such a program. In the latter case, federal or other uniform regulatory standards would likely supply the substance of the electronic presentment agreement, the application of which could be triggered by the use of some form of identifier on the item. Regulation CC, Section 229.36(c) authorizes truncation agreements but forbids them from extending return times or otherwise varying requirements of the part of Regulation CC governing check collection without the agreement of all parties interested in the check. For instance, an extension of return time could damage a depositary bank which must make funds available to its customers under mandatory availability schedules. The Expedited Funds Availability Act, 12 U.S.C. Section 4008(b)(2), directs the Federal Reserve Board to consider requiring that banks provide for check truncation.

3. The parties affected by an agreement for electronic presentment, with the exception of the customer, can be expected to protect themselves. For example, the payor bank can probably be expected to limit its risk of loss from drawer forgery by limiting the dollar amount of eligible items (Federal Reserve program), by reconcilement agreements (ABA Safekeeping program), by insurance (credit union share draft program), or by other means. Because agreements will exist, only minimal amendments are needed to make clear that the UCC does not prohibit electronic presentment.

§ 28-4-111. Statute of limitations. — An action to enforce an obligation, duty or right arising under this chapter must be commenced within three (3) years after the cause of action accrues.

History.

I.C., § 28-4-111, as added by 1993, ch. 288, § 14, p. 1019.

Official Comment

This section conforms to the period of limitations set by Section 3-118(g) for actions for breach of warranty and to enforce other obligations, duties or rights arising under Article 3. Bracketing "cause of action" recognizes that some states use a different term, such as "claim for relief."

Part 2
Collection of Items — Depositary and Collecting Banks

Idaho Code § 28-4-201

§ 28-4-201. Status of collecting bank as agent and provisional status of credits — Applicability of chapter — Item indorsed "pay any bank." — (1) Unless a contrary intent clearly appears and before the time that a settlement given by a collecting bank for an item is or becomes final, the bank, with respect to the item, is an agent or subagent of the owner of the item and any settlement given for the item is provisional. This provision applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn; but the continuance of ownership of an item by its owner and any rights of the owner to proceeds of the item are subject to rights of a collecting bank, such as those resulting from outstanding advances on the item and rights of recoupment or setoff. If an item is handled by banks for purposes of presentment, payment, collection, or return, the relevant provisions of this chapter apply even though action of the parties clearly establishes that a particular bank has purchased the item and is the owner of it.

(2) After an item has been indorsed with the words "pay any bank" or the like, only a bank may acquire the rights of a holder until the item has been:

(a) returned to the customer initiating collection; or

(b) specially indorsed by a bank to a person who is not a bank.

History.

1967, ch. 161, § 4-201, p. 351; am. 1993, ch. 288, § 15, p. 1019.

CASE NOTES

Bank Custom.

A custom among the banks to accept checks for collection and credit them to the depositor's accounts, reserving the right to charge them back to the depositor unless collected, was not violative of, but in conformity with, the bank collection act. Twin Falls Bank & Trust Co. v. Pringle, 55 Idaho 451, 43 P.2d 515 (1935).

Restrictive Indorsement.

Indorsement "for deposit only" by drawer of trade acceptance, who was also payee, was a restrictive indorsement after acceptance by the acceptor, which, unless waived, precluded indorsee from being a holder in due course. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

Cited Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

Official Comment

1. This section states certain basic rules of the bank collection process. One basic rule, appearing in the last sentence of subsection (a), is that, to the extent applicable, the provisions of the Article govern without regard to whether a bank handling an item owns the item or is an agent for collection. Historically, much time has been spent and effort expended in determining or attempting to determine whether a bank was a purchaser of an item or merely an agent for collection. See discussion of this subject and cases cited in 11 A.L.R. 1043, 16 A.L.R. 1084, 42 A.L.R. 492, 68 A.L.R. 725, 99 A.L.R. 486. See also Section 4 of the American Bankers Association Bank Collection Code. The general approach of Article 4, similar to that of other articles, is to provide, within reasonable limits, rules or answers to major problems known to exist in the bank collection process without regard to questions of status and ownership but to keep general principles such as status and ownership available to cover residual areas not covered by specific rules. In line with this approach, the last sentence of subsection (a) says in effect that Article 4 applies to practically every item moving through banks for the purpose of presentment, payment or collection.

2. Within this general rule of broad coverage, the first two sentences of subsection (a) state a rule of agency status. “Unless a contrary intent clearly appears” the status of a collecting bank is that of an agent or subagent for the owner of the item. Although as indicated in Comment 1 it is much less important under Article 4 to determine status than has been the case heretofore, status may have importance in some residual areas not covered by specific rules. Further, since status has been considered so important in the past, to omit all reference to it might cause confusion. The status of agency “applies regardless of the form of indorsement or lack of indorsement and even though credit given for the item is subject to immediate withdrawal as of right or is in fact withdrawn.” Thus questions heretofore litigated as to whether ordinary indorsements “for deposit,” “for collection” or in blank have the effect of creating an agency status or a purchase, no longer have significance in varying the prima facie rule of agency. Similarly, the nature of the credit given for an item or whether it is subject to immediate withdrawal as of right or is in fact withdrawn, does not alter the agency status. See A.L.R. references supra in Comment 1.

A contrary intent can change agency status but this must be clear. An example of a clear contrary intent would be if collateral papers established or the item bore a legend stating that the item was sold absolutely to the depositary bank.

3. The prima facie agency status of collecting banks is consistent with prevailing law and practice today. Section 2 of the American Bankers Association Bank Collection Code so provided. Legends on deposit tickets, collection letters and acknowledgments of items and Federal Reserve operating circulars consistently so provide. The status is consistent with rights of charge-back (Section 4-214 and Section 11 of the ABA Code) and risk of loss in the event of insolvency (Section 4-216 and Section 13 of the ABA Code). The right of charge-back with respect to checks is limited by Regulation CC, Section 226.36(d).

4. Affirmative statement of a prima facie agency status for collecting banks requires certain limitations and qualifications. Under current practices substantially all bank collections sooner or later merge into bank credits, at least if collection is effected. Usually, this takes place within a few days of the initiation of collection. An intermediary bank receives final collection and evidences the result of its collection by a “credit” on its books to the

depositary bank. The depositary bank evidences the results of its collection by a "credit" in the account of its customer. As used in these instances the term "credit" clearly indicates a debtor-creditor relationship. At some stage in the bank collection process the agency status of a collecting bank changes to that of debtor, a debtor of its customer. Usually at about the same time it also becomes a creditor for the amount of the item, a creditor of some intermediary, payor or other bank. Thus the collection is completed, all agency aspects are terminated and the identity of the item has become completely merged in bank accounts, that of the customer with the depositary bank and that of one bank with another.

Although Section 4-215(a) provides that an item is finally paid when the payor bank takes or fails to take certain action with respect to the item, the final payment of the item may or may not result in the simultaneous final settlement for the item in the case of all prior parties. If a series of provisional debits and credits for the item have been entered in accounts between banks, the final payment of the item by the payor bank may result in the automatic firming up of all these provisional debits and credits under Section 4-215(c), and the consequent receipt of final settlement for the item by each collecting bank and the customer of the depositary bank simultaneously with such action of the payor bank. However, if the payor bank or some intermediary bank accounts for the item with a remittance draft, the next prior bank usually does not receive final settlement for the item until the remittance draft finally clears. See Section 4-213(c). The first sentence of subsection (a) provides that the agency status of a collecting bank (whether intermediary or depositary) continues until the settlement given by it for the item is or becomes final. In the case of the series of provisional credits covered by Section 4-215(c), this could be simultaneously with the final payment of the item by the payor bank. In cases in which the remittance drafts are used or in straight noncash collections, this would not be until the times specified in Sections 4-213(c) and 4-215(d). With respect to checks Regulation CC Sections 229.31(c), 229.32(b), and 229.36(d) provide that all settlements between banks are final in both the forward collection and return of checks.

Under Section 4-213(a) settlements for items may be made by any means agreed to by the parties. Since it is impossible to contemplate all the kinds of settlements that will be utilized, no attempt is made in Article 4 to

provide when settlement is final in all cases. The guiding principle is that settlements should be final when the presenting person has received usable funds. Section 4-213(c) and (d) and Section 4-215(c) provide when final settlement occurs with respect to certain kinds of settlement, but these provisions are not intended to be exclusive.

A number of practical results flow from the rule continuing the agency status of a collecting bank until its settlement for the item is or becomes final, some of which are specifically set forth in this Article. One is that risk of loss continues in the owner of the item rather than the agent bank. See Section 4-214. Offsetting rights favorable to the owner are that pending such final settlement, the owner has the preference rights of Section 4-216 and the direct rights of Section 4-302 against the payor bank. It also follows from this rule that the dollar limitations of Federal Deposit Insurance are measured by the claim of the owner of the item rather than that of the collecting bank. With respect to checks, rights of the parties in insolvency are determined by Regulation CC Section 229.39 and the liability of a bank handling a check to a subsequent bank that does not receive payment because of suspension of payments by another bank is stated in Regulation CC Section 229.35(b).

5. In those cases in which some period of time elapses between the final payment of the item by the payor bank and the time that the settlement of the collecting bank is or becomes final, e.g., if the payor bank or an intermediary bank accounts for the item with a remittance draft or in straight noncash collections, the continuance of the agency status of the collecting bank necessarily carries with it the continuance of the owner's status as principal. The second sentence of subsection (a) provides that whatever rights the owner has to proceeds of the item are subject to the rights of collecting banks for outstanding advances on the item and other valid rights, if any. The rule provides a sound rule to govern cases of attempted attachment of proceeds of a noncash item in the hands of the payor bank as property of the absent owner. If a collecting bank has made an advance on an item which is still outstanding, its right to obtain reimbursement for this advance should be superior to the rights of the owner to the proceeds or to the rights of a creditor of the owner. An intentional crediting of proceeds of an item to the account of a prior bank known to be insolvent, for the purpose of acquiring a right of setoff, would

not produce a valid setoff. See 8 Zollman, Banks and Banking (1936) Sec. 5443.

6. This section and Article 4 as a whole represent an intentional abandonment of the approach to bank collection problems appearing in Section 4 of the American Bankers Association Bank Collection Code. Because the tremendous volume of items handled makes impossible the examination by all banks of all indorsements on all items and thus in fact this examination is not made, except perhaps by depositary banks, it is unrealistic to base the rights and duties of all banks in the collection chain on variations in the form of indorsements. It is anomalous to provide throughout the ABA Code that the prima facie status of collecting banks is that of agent or subagent but in Section 4 to provide that subsequent holders (subagents) shall have the right to rely on the presumption that the bank of deposit (the primary agent) is the owner of the item. It is unrealistic, particularly in this background, to base rights and duties on status of agent or owner. Thus Section 4-201 makes the pertinent provisions of Article 4 applicable to substantially all items handled by banks for presentment, payment or collection, recognizes the prima facie status of most banks as agents, and then seeks to state appropriate limits and some attributes to the general rules so expressed.

7. Subsection (b) protects the ownership rights with respect to an item indorsed “pay any bank or banker” or in similar terms of a customer initiating collection or of any bank acquiring a security interest under Section 4-210, in the event the item is subsequently acquired under improper circumstances by a person who is not a bank and transferred by that person to another person, whether or not a bank. Upon return to the customer initiating collection of an item so indorsed, the indorsement may be cancelled (Section 3-207). A bank holding an item so indorsed may transfer the item out of banking channels by special indorsement; however, under Section 4-103(e), the bank would be liable to the owner of the item for any loss resulting therefrom if the transfer had been made in bad faith or with lack of ordinary care. If briefer and more simple forms of bank indorsements are developed under Section 4-206 (e.g., the use of bank transit numbers in lieu of present lengthy forms of bank indorsements), a depositary bank having the transit number “X100” could make subsection (b) operative by indorsements such as “Pay any bank — X100.” Regulation

CC Section 229.35(c) states the effect of an indorsement on a check by a bank.

§ 28-4-202. Responsibility for collection or return — When action timely. — (1) A collecting bank must exercise ordinary care in:

(a) presenting an item or sending it for presentment;

(b) sending notice of dishonor or nonpayment or returning an item other than a documentary draft to the bank's transferor after learning that the item has not been paid or accepted, as the case may be;

(c) settling for an item when the bank receives final settlement; and

(d) notifying its transferor of any loss or delay in transit within a reasonable time after discovery thereof.

(2) A collecting bank exercises ordinary care under subsection (1) of this section by taking proper action before its midnight deadline following receipt of an item, notice or settlement. Taking proper action within a reasonably longer time may constitute the exercise of ordinary care, but the bank has the burden of establishing timeliness.

(3) Subject to subsection (1)(a) of this section, a bank is not liable for the insolvency, neglect, misconduct, mistake or default of another bank or person or for loss or destruction of an item in the possession of others or in transit.

History.

1967, ch. 161, § 4-202, p. 351; am. 1993, ch. 288, § 16, p. 1019.

CASE NOTES

Decisions Under Prior Law

Bank Custom.

As a general proposition every commercial contract, including those in connection with banking business, was deemed entered into with understanding that usage and custom in regard to particular matter of contract becomes part of transaction itself unless the contrary appears. Fischer v. First Nat'l Bank, 55 Idaho 251, 40 P.2d 625 (1935).

Since former statute did not specify any time for holding checks or items received from foreign correspondents, a banking custom to hold such items until close of business day upon which received was valid and reasonable. Fischer v. First Nat'l Bank, 55 Idaho 251, 40 P.2d 625 (1935).

Official Comment

1. Subsection (a) states the basic responsibilities of a collecting bank. Of course, under Section 1-203 a collecting bank is subject to the standard requirement of good faith. By subsection (a) it must also use ordinary care in the exercise of its basic collection tasks. By Section 4-103(a) neither requirement may be disclaimed.

2. If the bank makes presentment itself, subsection (a)(1) requires ordinary care with respect both to the time and manner of presentment. (Sections 3-501 and 4-212.) If it forwards the item to be presented the subsection requires ordinary care with respect to routing (Section 4-204), and also in the selection of intermediary banks or other agents.

3. Subsection (a) describes types of basic action with respect to which a collecting bank must use ordinary care. Subsection (b) deals with the time for taking action. It first prescribes the general standard for timely action, namely for items received on Monday, proper action (such as forwarding or presenting) on Monday or Tuesday is timely. Although under current "production line" operations banks customarily move items along on regular schedules substantially briefer than two days, the subsection states an outside time within which a bank may know it has taken timely action. To provide flexibility from this standard norm, the subsection further states that action within a reasonably longer time may be timely but the bank has the burden of proof. In the case of time items, action after the midnight deadline, but sufficiently in advance of maturity for proper presentation, is a clear example of a "reasonably longer time" that is timely. The standard of requiring action not later than Tuesday in the case of Monday items is also subject to possibilities of variation under the general provisions of Section 4-103, or under the special provisions regarding time of receipt of items (Section 4-108), and regarding delays (Section 4-109). This subsection (b) deals only with collecting banks. The time limits applicable to payor banks appear in Sections 4-301 and 4-302.

4. At common law the so-called New York collection rule subjected the initial collecting bank to liability for the actions of subsequent banks in the collection chain; the so-called Massachusetts rule was that each bank, subject to the duty of selecting proper intermediaries, was liable only for its own negligence. Subsection (c) adopts the Massachusetts rule. But since this is stated to be subject to subsection (a)(1) a collecting bank remains responsible for using ordinary care in selecting properly qualified intermediary banks and agents and in giving proper instructions to them. Regulation CC Section 229.36(d) states the liability of a bank during the forward collection of checks.

§ 28-4-203. Effect of instructions. — Subject to the provisions of chapter 3[, title 28, Idaho Code,] concerning conversion of instruments (section 28-3-420[, Idaho Code]) and restrictive indorsements (section 28-3-206[, Idaho Code]), only a collecting bank's transferor can give instructions that affect the bank or constitute notice to it and a collecting bank is not liable to prior parties for any action taken pursuant to the instructions or in accordance with any agreement with its transferor.

History.

1967, ch. 161, § 4-203, p. 351; am. 1993, ch. 288, § 17, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions throughout this section were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Decisions Under Prior Law Bank Custom.

A custom among the banks to accept checks for collection and credit them to the depositor's accounts, reserving the right to charge them back to the depositor unless collected, was not violative of, but in conformity with the bank collection act. Twin Falls Bank & Trust Co. v. Pringle, 55 Idaho 451, 43 P.2d 515 (1935).

Official Comment This section adopts a "chain of command" theory which renders it unnecessary for an intermediary or collecting bank to determine whether its transferor is "authorized" to give the instructions. Equally the bank is not put on notice of any "revocation of authority" or "lack of authority" by notice received from any other person. The desirability of speed in the collection process and the fact

that, by reason of advances made, the transferor may have the paramount interest in the item requires the rule.

The section is made subject to the provisions of Article 3 concerning conversion of instruments (Section 3-420) and restrictive indorsements (Section 3-206). Of course instructions from or an agreement with its transferor does not relieve a collecting bank of its general obligation to exercise good faith and ordinary care. See Section 4-103(a). If in any particular case a bank has exercised good faith and ordinary care and is relieved of responsibility by reason of instructions of or an agreement with its transferor, the owner of the item may still have a remedy for loss against the transferor (another bank) if such transferor has given wrongful instructions.

The rules of the section are applied only to collecting banks. Payor banks always have the problem of making proper payment of an item; whether such payment is proper should be based upon all of the rules of Articles 3 and 4 and all of the facts of any particular case, and should not be dependent exclusively upon instructions from or an agreement with a person presenting the item.

§ 28-4-204. Methods of sending and presenting — Sending directly to payor bank. — (1) A collecting bank shall send items by a reasonably prompt method, taking into consideration relevant instructions, the nature of the item, the number of those items on hand, the cost of collection involved and the method generally used by it or others to present those items.

(2) A collecting bank may send: (a) an item directly to the payor bank; (b) an item to a nonbank payor if authorized by its transferor; and (c) an item other than documentary drafts to a nonbank payor, if authorized by federal reserve regulation or operating circular, clearing-house rule or the like.

(3) Presentment may be made by a presenting bank at a place where the payor bank or other payor has requested that presentment be made.

History.

1967, ch. 161, § 4-204, p. 351; am. 1993, ch. 288, § 18, p. 1019.

CASE NOTES

Cited Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

Decisions Under Prior Law

Payment of Check.

Check received by drawee bank as collecting agent, and not charged to depositor's account, was not paid. Davison v. Allen, 47 Idaho 405, 276 P. 43 (1929).

Official Comment

1. Subsection (a) prescribes the general standards applicable to proper sending or forwarding of items. Because of the many types of methods available and the desirability of preserving flexibility any attempt to prescribe limited or precise methods is avoided.

2. Subsection (b)(1) codifies the practice of direct mail, express, messenger or like presentment to payor banks. The practice is now country-wide and is justified by the need for speed, the general responsibility of banks, Federal Deposit Insurance protection and other reasons.

3. Full approval of the practice of direct sending is limited to cases in which a bank is a payor. Since nonbank drawees or payors may be of unknown responsibility, substantial risks may be attached to placing in their hands the instruments calling for payments from them. This is obviously so in the case of documentary drafts. However, in some cities practices have long existed under clearing-house procedures to forward certain types of items to certain nonbank payors. Examples include insurance loss drafts drawn by field agents on home offices. For the purpose of leaving the door open to legitimate practices of this kind, subsection (b)(3) affirmatively approves direct sending of any item other than documentary drafts to any nonbank payor, if authorized by Federal Reserve regulation or operating circular, clearing-house rule or the like.

On the other hand subsection (b)(2) approves sending any item directly to a nonbank payor if authorized by a collecting bank's transferor. This permits special instructions or agreements out of the norm and is consistent with the "chain of command" theory of Section 4-203. However, if a transferor other than the owner of the item, e.g., a prior collecting bank, authorizes a direct sending to a nonbank payor, such transferor assumes responsibility for the propriety or impropriety of such authorization.

4. Section 3-501(b) provides where presentment may be made. This provision is expressly subject to Article 4. Section 4-204(c) specifically approves presentment by a presenting bank at any place requested by the payor bank or other payor. The time when a check is received by a payor bank for presentment is governed by Regulation CC Section 229.36(b).

§ 28-4-205. Depositary bank holder of unindorsed item. — If a customer delivers an item to a depositary bank for collection:

(1) The depositary bank becomes a holder of the item at the time it receives the item for collection if the customer at the time of delivery was a holder of the item, whether or not the customer indorses the item, and, if the bank satisfies the other requirements of section 28-3-302[, Idaho Code], it is a holder in due course; and (2) The depositary bank warrants to collecting banks, the payor bank or other payor, and the drawer that the amount of the item was paid to the customer or deposited to the customer's account.

History.

1967, ch. 161, § 4-205, p. 351; am. 1993, ch. 288, § 19, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in subsection (1) was added by the compiler to conform to the statutory citation style.

CASE NOTES

Cited Coeur d'Alene Mining Co. v. First Nat'l Bank, 118 Idaho 812, 800 P.2d 1026 (1990).

RESEARCH REFERENCES

ALR. — Collection, construction and application of UCC § 4-205(1) allowing depositary bank to supply customer's endorsement on item for collection. 29 A.L.R.4th 631.

Official Comment Section 3-201(b) provides that negotiation of an instrument payable to order requires indorsement by the holder. The rule of former Section 4-205(1) was that the depositary bank may supply a missing indorsement of its customer unless the item contains the words "payee's indorsement required" or the like. The cases have

differed on the status of the depositary bank as a holder if it fails to supply its customer's indorsement. *Marine Midland Bank, N.A. v. Price, Miller, Evans & Flowers,* 446 N.Y.S.2d 797 (N.Y. App. Div. 4th Dept. 1981), rev'd 455 N.Y.S.2d 565 (N.Y. 1982). It is common practice for depositary banks to receive unindorsed checks under so-called "lock-box" agreements from customers who receive a high volume of checks. No function would be served by requiring a depositary bank to run these items through a machine that would supply the customer's indorsement except to afford the drawer and the subsequent banks evidence that the proceeds of the item reached the customer's account. Paragraph (1) provides that the depositary bank becomes a holder when it takes the item for deposit if the depositor is a holder. Whether it supplies the customer's indorsement is immaterial. Paragraph (2) satisfies the need for a receipt of funds by the depositary bank by imposing on that bank a warranty that it paid the customer or deposited the item to the customer's account. This warranty runs not only to collecting banks and to the payor bank or nonbank drawee but also to the drawer, affording protection to these parties that the depositary bank received the item and applied it to the benefit of the holder.

§ 28-4-206. Transfer between banks. — Any agreed method that identifies the transferor bank is sufficient for the item's further transfer to another bank.

History.

1967, ch. 161, § 4-206, p. 351; am. 1993, ch. 288, § 20, p. 1019.

Official Comment

This section is designed to permit the simplest possible form of transfer from one bank to another, once an item gets in the bank collection chain, provided only identity of the transferor bank is preserved. This is important for tracing purposes and if recourse is necessary. However, since the responsibilities of the various banks appear in the Article it becomes unnecessary to have liability or responsibility depend on more formal indorsements. Simplicity in the form of transfer is conducive to speed. If the transfer is between banks, this section takes the place of the more formal requirements of Section 3-201.

§ 28-4-207. Transfer warranties. — (1) A customer or collecting bank that transfers an item and receives a settlement or other consideration warrants to the transferee and to any subsequent collecting bank that:

(a) The warrantor is a person entitled to enforce the item;

(b) All signatures on the item are authentic and authorized;

(c) The item has not been altered;

(d) The item is not subject to a defense or claim in recoupment (section 28-3-305(1)[, Idaho Code]) of any party that can be asserted against the warrantor;

(e) The warrantor has no knowledge of any insolvency proceeding commenced with respect to the maker or acceptor or, in the case of an unaccepted draft, the drawer; and

(f) If the item is a demand draft, creation of the item according to the terms on its face was authorized by the person identified as drawer.

(2) If an item is dishonored, a customer or collecting bank transferring the item and receiving settlement or other consideration is obliged to pay the amount due on the item (i) according to the terms of the item at the time it was transferred, or (ii) if the transfer was of an incomplete item, according to its terms when completed as stated in sections 28-3-115 and 28-3-407[, Idaho Code]. The obligation of a transferor is owed to the transferee and to any subsequent collecting bank that takes the item in good faith. A transferor cannot disclaim its obligation under this subsection by an indorsement stating that it is made "without recourse" or otherwise disclaiming liability.

(3) A person to whom the warranties under subsection (1) of this section are made and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, but not more than the amount of the item plus expenses and loss of interest incurred as a result of the breach.

(4) The warranties stated in subsection (1) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of

warranty is given to the warrantor within thirty (30) days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(5) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(6) If the warranty in subsection (1)(f) of this section is not given by a transferor under applicable conflict of law rules, the warranty is not given to that transferor when the transferor is a transferee, nor to any prior collecting bank.

History.

I.C., § 28-4-207, as added by 1993, ch. 288, § 22, p. 1019; am. 2002, ch. 121, § 5, p. 369.

STATUTORY NOTES

Prior Laws.

Former § 28-4-207, which comprised 1967, ch. 161, § 4-207, p. 351, was repealed by S.L. 1993, ch. 288, § 21, effective July 1, 1993.

Compiler's Notes.

The bracketed insertions in paragraph (1)(d) and subsection (2) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Decisions Under Prior Law

Restrictive Indorsement.

Indorsement "for deposit only" by drawer of trade acceptance, who was also the payee, was a restrictive indorsement after acceptance by the acceptor, which, unless waived, precluded indorsee from being a holder in due course. Continental Nat'l Bank & Trust Co. v. Stirling, 65 Idaho 123, 140 P.2d 230 (1943).

RESEARCH REFERENCES

Am. Jur. 2d. — 12 Am. Jur. 2d, Bills and Notes, § 468 et seq.

Official Comment

Except for subsection (b), this section conforms to Section 3-416 and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-416. Subsection (b) provides that customers or collecting banks that transfer items, whether by indorsement or not, undertake to pay the item if the item is dishonored. This obligation cannot be disclaimed by a "without recourse" indorsement or otherwise. With respect to checks, Regulation CC Section 229.34 states the warranties made by paying and returning banks.

§ 28-4-208. Presentment warranties. — (1) If an unaccepted draft is presented to the drawee for payment or acceptance and the drawee pays or accepts the draft, (i) the person obtaining payment or acceptance, at the time of presentment, and (ii) a previous transferor of the draft, at the time of transfer, warrant to the drawee that pays or accepts the draft in good faith that:

(a) The warrantor is, or was, at the time the warrantor transferred the draft, a person entitled to enforce the draft or authorized to obtain payment or acceptance of the draft on behalf of a person entitled to enforce the draft;

(b) The draft has not been altered;

(c) The warrantor has no knowledge that the signature of the purported drawer of the draft is unauthorized; and

(d) If the draft is a demand draft, creation of the demand draft according to the terms on its face was authorized by the person identified as drawer.

(2) A drawee making payment may recover from a warrantor damages for breach of warranty equal to the amount paid by the drawee less the amount the drawee received or is entitled to receive from the drawer because of the payment. In addition, the drawee is entitled to compensation for expenses and loss of interest resulting from the breach. The right of the drawee to recover damages under this subsection is not affected by any failure of the drawee to exercise ordinary care in making payment. If the drawee accepts the draft (i) breach of warranty is a defense to the obligation of the acceptor, and (ii) if the acceptor makes payment with respect to the draft, the acceptor is entitled to recover from a warrantor for breach of warranty the amounts stated in this subsection.

(3) If a drawee asserts a claim for breach of warranty under subsection (1) of this section based on an unauthorized indorsement of the draft or an alteration of the draft, the warrantor may defend by proving that the indorsement is effective under section 28-3-404 or 28-3-405[, Idaho Code,] or the drawer is precluded under section 28-3-406 or 28-4-406[, Idaho

Code,] from asserting against the drawee the unauthorized indorsement or alteration.

(4) If (i) a dishonored draft is presented for payment to the drawer or an indorser or (ii) any other item is presented for payment to a party obliged to pay the item, and the item is paid, the person obtaining payment and a prior transferor of the item warrant to the person making payment in good faith that the warrantor is, or was, at the time the warrantor transferred the item, a person entitled to enforce the item or authorized to obtain payment on behalf of a person entitled to enforce the item. The person making payment may recover from any warrantor for breach of warranty an amount equal to the amount paid plus expenses and loss of interest resulting from the breach.

(5) The warranties stated in subsections (1) and (2) of this section cannot be disclaimed with respect to checks. Unless notice of a claim for breach of warranty is given to the warrantor within thirty (30) days after the claimant has reason to know of the breach and the identity of the warrantor, the warrantor is discharged to the extent of any loss caused by the delay in giving notice of the claim.

(6) A cause of action for breach of warranty under this section accrues when the claimant has reason to know of the breach.

(7) A demand draft is a check, as provided in section 28-3-104[, Idaho Code].

(8) If the warranty in subsection (1)(d) of this section is not given by a transferor under applicable conflict of law rules, the warranty is not given to that transferor when the transferor is a transferee.

History.

I.C., § 28-4-208, as added by 1993, ch. 288, § 23, p. 1019; am. 2002, ch. 121, § 6, p. 338.

STATUTORY NOTES

Compiler's Notes.

Former § 28-4-208 was amended and redesignated as § 28-4-210 by § 25 of S.L. 1993, ch. 288.

The bracketed insertions in subsections (3) and (7) were added by the compiler to conform to the statutory citation style.

Official Comment

This section conforms to Section 3-417 and extends its coverage to items. The substance of this section is discussed in the Comment to Section 3-417. "Draft" is defined in Section 4-104 as including an item that is an order to pay so as to make clear that the term "draft" in Article 4 may include items that are not instruments within Section 3-104.

§ 28-4-209. Encoding and retention warranties. — (1) A person who encodes information on or with respect to an item after issue warrants to any subsequent collecting bank and to the payor bank or other payor that the information is correctly encoded. If the customer of a depositary bank encodes, that bank also makes the warranty.

(2) A person who undertakes to retain an item pursuant to an agreement for electronic presentment warrants to any subsequent collecting bank and to the payor bank or other payor that retention and presentment of the item comply with the agreement. If a customer of a depositary bank undertakes to retain an item, that bank also makes this warranty.

(3) A person to whom warranties are made under this section and who took the item in good faith may recover from the warrantor as damages for breach of warranty an amount equal to the loss suffered as a result of the breach, plus expenses and loss of interest incurred as a result of the breach.

History.

I.C., § 28-4-209, as added by 1993, ch. 288, § 24, p. 1019.

STATUTORY NOTES

Compiler's Notes.

Former § 28-4-209 was amended and redesignated as § 28-4-211 by § 26 of S.L. 1993, ch. 288.

Official Comment

1. Encoding and retention warranties are included in Article [chapter] 4 because they are unique to the bank collection process. These warranties are breached only by the person doing the encoding or retaining the item and not by subsequent banks handling the item. Encoding and check retention may be done by customers who are payees of a large volume of checks; hence, this section imposes warranties on customers as well as banks. If a customer encodes or retains, the depositary bank is also liable for any breach of this warranty.

2. A misencoding of the amount on the MICR line is not an alteration under Section 3-407(a) which defines alteration as changing the contract of the parties. If a drawer wrote a check for $2,500 and the depositary bank encoded $25,000 on the MICR line, the payor bank could debit the drawer's account for only $2,500. This subsection would allow the payor bank to hold the depositary bank liable for the amount paid out over $2,500 without first pursuing the person who received payment. Intervening collecting banks would not be liable to the payor bank for the depositary bank's error. If a drawer wrote a check for $25,000 and the depositary bank encoded $2,500, the payor bank becomes liable for the full amount of the check. The payor bank's rights against the depositary bank depend on whether the payor bank has suffered a loss. Since the payor bank can debit the drawer's account for $25,000, the payor bank has a loss only to the extent that the drawer's account is less than the full amount of the check. There is no requirement that the payor bank pursue collection against the drawer beyond the amount in the drawer's account as a condition to the payor bank's action against the depositary bank for breach of warranty. See *Georgia Railroad Bank & Trust Co. v. First National Bank & Trust,* 229 S.E.2d 482 (Ga. App. 1976), aff'd, 235 S.E.2d 1 (Ga. 1977), and *First National Bank of Boston v. Fidelity Bank, National Association,* 724 F. Supp. 1168 (E.D. Pa. 1989).

3. A person retaining items under an electronic presentment agreement (Section 4-110) warrants that it has complied with the terms of the agreement regarding its possession of the item and its sending a proper presentment notice. If the keeper is a customer, its depositary bank also makes this warranty.

§ 28-4-210. Security interest of collecting bank in items, accompanying documents and proceeds. — (1) A collecting bank has a security interest in an item and any accompanying documents or the proceeds of either:

(a) In case of an item deposited in an account, to the extent to which credit given for the item has been withdrawn or applied;

(b) In case of an item for which it has given credit available for withdrawal as of right, to the extent of the credit given, whether or not the credit is drawn upon or there is a right of charge-back; or

(c) If it makes an advance on or against the item.

(2) If credit given for several items received at one (1) time or pursuant to a single agreement is withdrawn or applied in part, the security interest remains upon all the items, any accompanying documents or the proceeds of either. For the purpose of this section, credits first given are first withdrawn.

(3) Receipt by a collecting bank of a final settlement for an item is a realization on its security interest in the item, accompanying documents and proceeds. So long as the bank does not receive final settlement for the item or give up possession of the item or possession or control of the accompanying documents for purposes other than collection, the security interest continues to that extent and is subject to the provisions of chapter 9, title 28, Idaho Code, but:

(a) No security agreement is necessary to make the security interest enforceable (section 28-9-203(b)(3)(A)[, Idaho Code]);

(b) No filing is required to perfect the security interest; and

(c) The security interest has priority over conflicting perfected security interests in the item, accompanying documents or proceeds.

History.

1967, ch. 161, § 4-208, p. 351; am. and redesig. 1993, ch. 288, § 25, p. 1019; am. 2001, ch. 208, § 10, p. 704; am. 2004, ch. 42, § 19, p. 77.

STATUTORY NOTES

Compiler's Notes.

This section was formerly compiled as § 28-4-208.

Former § 28-4-210 was amended and redesignated as § 28-4-212 by § 27 of S.L. 1993, ch. 288.

The bracketed insertion in paragraph (3)(a) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 248.

15A Am. Jur. 2d, Commercial Code, § 8.

Official Comment

1. Subsection (a) states a rational rule for the interest of a bank in an item. The customer of the depositary bank is normally the owner of the item and the several collecting banks are agents of the customer (Section 4-201). A collecting agent may properly make advances on the security of paper held for collection, and acquires at common law a possessory lien for these advances. Subsection (a) applies an analogous principle to a bank in the collection chain which extends credit on items in the course of collection. The bank has a security interest to the extent stated in this section. To the extent of its security interest it is a holder for value (Sections 3-303, 4-211) and a holder in due course if it satisfies the other requirements for that status (Section 3-302). Subsection (a) does not derogate from the banker's general common law lien or right of setoff against indebtedness owing in deposit accounts. See Section 1-103. Rather subsection (a) specifically implements and extends the principle as a part of the bank collection process.

2. Subsection (b) spreads the security interest of the bank over all items in a single deposit or received under a single agreement and a single giving of credit. It also adopts the "first-in, first-out" rule.

3. Collection statistics establish that the vast majority of items handled for collection are in fact collected. The first sentence of subsection (c) reflects the fact that in the normal case the bank's security interest is self-liquidating. The remainder of the subsection correlates the security interest with the provisions of Article 9, particularly for use in the cases of noncollection in which the security interest may be important.

§ 28-4-211. When bank gives value for purposes of holder in due course. — For purposes of determining its status as a holder in due course, a bank has given value to the extent it has a security interest in an item, if the bank otherwise complies with the requirements of section 28-3-302[, Idaho Code,] on what constitutes a holder in due course.

History.

1967, ch. 161, § 4-209, p. 351; am. and redesig. 1993, ch. 288, § 26, p. 1019.

STATUTORY NOTES

Prior Laws.

Former § 28-4-211, which comprised 1967, ch. 161, § 4-211, p. 351, was repealed by S.L. 1993, ch. 288, § 28, effective July 1, 1993.

Compiler's Notes.

This section was formerly compiled as § 28-4-209.

The bracketed insertion in this section was added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 8.

Official Comment

The section completes the thought of the previous section and makes clear that a security interest in an item is "value" for the purpose of determining the holder's status as a holder in due course. The provision is in accord with the prior law (N.I.L. Section 27) and with Article 3 (Section 3-303). The section does not prescribe a security interest under Section 4-210 as a test of "value" generally because the meaning of "value" under other Articles is adequately defined in Section 1-201.

§ 28-4-212. Presentment by notice of item not payable by, through or at a bank — Liability of drawer or indorser. — (1) Unless otherwise instructed, a collecting bank may present an item not payable by, through or at a bank by sending to the party to accept or pay a written notice that the bank holds the item for acceptance or payment. The notice must be sent in time to be received on or before the day when presentment is due and the bank must meet any requirement of the party to accept or pay under section 28-3-501[, Idaho Code,] by the close of the bank's next banking day after it knows of the requirement.

(2) If presentment is made by notice and payment, acceptance or request for compliance with a requirement under section 28-3-501[, Idaho Code,] is not received by the close of business on the day after maturity or, in the case of demand items, by the close of business on the third banking day after notice was sent, the presenting bank may treat the item as dishonored and charge any drawer or indorser by sending it notice of the facts.

History.

1967, ch. 161, § 4-210, p. 351; am. and redesig. 1993, ch. 288, § 27, p. 1019.

STATUTORY NOTES

Compiler's Notes.

This section was formerly compiled as § 28-4-210.

Former § 28-4-212 was amended and redesignated as § 28-4-214 by § 30 of S.L. 1993, ch. 288.

The bracketed insertions in subsections (1) and (2) were added by the compiler to conform to the statutory citation style.

Official Comment

1. This section codifies a practice extensively followed in presentation of trade acceptances and documentary and other drafts drawn on non-bank payors. It imposes a duty on the payor to respond to the notice of the item if

the item is not to be considered dishonored. Notice of such a dishonor charges drawers and indorsers. Presentment under this section is good presentment under Article 3. See Section 3-501.

2. A drawee not receiving notice is not, of course, liable to the drawer for wrongful dishonor.

3. A bank so presenting an instrument must be sufficiently close to the drawee to be able to exhibit the instrument on the day it is requested to do so or the next business day at the latest.

§ 28-4-213. Medium and time of settlement by bank. — (1) With respect to settlement by a bank, the medium and time of settlement may be prescribed by federal reserve regulations or circulars, clearing-house rules, and the like, or agreement. In the absence of such prescription:

(a) The medium of settlement is cash or credit to an account in a federal reserve bank of or specified by the person to receive settlement; and

(b) The time of settlement is:

(i) With respect to tender of settlement by cash, a cashier's check, or teller's check, when the cash or check is sent or delivered;

(ii) With respect to tender of settlement by credit in an account in a federal reserve bank, when the credit is made;

(iii) With respect to tender of settlement by a credit or debit to an account in a bank, when the credit or debit is made or, in the case of tender of settlement by authority to charge an account, when the authority is sent or delivered; or

(iv) With respect to tender of settlement by a funds transfer, when payment is made pursuant to section 28-4-631(1)[, Idaho Code,] to the person receiving settlement.

(2) If the tender of settlement is not by a medium authorized by subsection (1) of this section or the time of settlement is not fixed by subsection (1) of this section, no settlement occurs until the tender of settlement is accepted by the person receiving settlement.

(3) If settlement for an item is made by cashier's check or teller's check and the person receiving settlement, before its midnight deadline:

(a) Presents or forwards the check for collection, settlement is final when the check is finally paid; or

(b) Fails to present or forward the check for collection, settlement is final at the midnight deadline of the person receiving settlement.

(4) If settlement for an item is made by giving authority to charge the account of the bank giving settlement in the bank receiving settlement,

settlement is final when the charge is made by the bank receiving settlement if there are funds available in the account for the amount of the item.

History.

I.C., § 28-4-213, as added by 1993, ch. 288, § 29, p. 1019.

STATUTORY NOTES

Compiler's Notes.

Former § 28-4-213 was amended and redesignated as § 28-4-215 by § 31 of S.L. 1993, ch. 288.

The bracketed insertion in paragraph (1)(b)(iv) was added by the compiler to conform to the statutory citation style.

Official Comment

1. Subsection (a) sets forth the medium of settlement that the person receiving settlement must accept. In nearly all cases the medium of settlement will be determined by agreement or by Federal Reserve regulations and circulars, clearing-house rules, and the like. In the absence of regulations, rules or agreement, the person receiving settlement may demand cash or credit in a Federal Reserve bank. If the person receiving settlement does not have an account in a Federal Reserve bank, it may specify the account of another bank in a Federal Reserve bank. In the unusual case in which there is no agreement on the medium of settlement and the bank making settlement tenders settlement other than cash or Federal Reserve bank credit, no settlement has occurred under subsection (b) unless the person receiving settlement accepts the settlement tendered. For example, if a payor bank, without agreement, tenders a teller's check, the bank receiving the settlement may reject the check and return it to the payor bank or it may accept the check as settlement.

2. In several provisions of Article 4 the time that a settlement occurs is relevant. Subsection (a) sets out a general rule that the time of settlement, like the means of settlement, may be prescribed by agreement. In the absence of agreement, the time of settlement for tender of the common agreed media of settlement is that set out in subsection (a)(2). The time of

settlement by cash, cashier's or teller's check or authority to charge an account is the time the cash, check or authority is sent, unless presentment is over the counter in which case settlement occurs upon delivery to the presenter. If there is no agreement on the time of settlement and the tender of settlement is not made by one of the media set out in subsection (a), under subsection (b) the time of settlement is the time the settlement is accepted by the person receiving settlement.

3. Subsections (c) and (d) are special provisions for settlement by remittance drafts and authority to charge an account in the bank receiving settlement. The relationship between final settlement and final payment under Section 4-215 is addressed in subsection (b) of Section 4-215. With respect to settlement by cashier's checks or teller's checks, other than in response to over-the-counter presentment, the bank receiving settlement can keep the risk that the check will not be paid on the bank tendering the check in settlement by acting to initiate collection of the check within the midnight deadline of the bank receiving settlement. If the bank fails to initiate settlement before its midnight deadline, final settlement occurs at the midnight deadline, and the bank receiving settlement assumes the risk that the check will not be paid. If there is no agreement that permits the bank tendering settlement to tender a cashier's or teller's check, subsection (b) allows the bank receiving the check to reject it, and, if it does, no settlement occurs. However, if the bank accepts the check, settlement occurs and the time of final settlement is governed by subsection (c).

With respect to settlement by tender of authority to charge the account of the bank making settlement in the bank receiving settlement, subsection (d) provides that final settlement does not take place until the account charged has available funds to cover the amount of the item. If there is no agreement that permits the bank tendering settlement to tender an authority to charge an account as settlement, subsection (b) allows the bank receiving the tender to reject it. However, if the bank accepts the authority, settlement occurs and the time of final settlement is governed by subsection (d).

§ 28-4-214. Right of charge-back or refund — Liability of collecting bank — Return of item. — (1) If a collecting bank has made provisional settlement with its customer for an item and fails by reason of dishonor, suspension of payments by a bank, or otherwise to receive a settlement for the item which is or becomes final, the bank may revoke the settlement given by it, charge back the amount of any credit given for the item to its customer's account, or obtain refund from its customer, whether or not it is able to return the item, if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts. If the return or notice is delayed beyond the bank's midnight deadline or a longer reasonable time after it learns the facts, the bank may revoke the settlement, charge back the credit, or obtain refund from its customer, but it is liable for any loss resulting from the delay. These rights to revoke, charge back and obtain refund terminate if and when a settlement for the item received by the bank is or becomes final.

(2) A collecting bank returns an item when it is sent or delivered to the bank's customer or transferor or pursuant to its instructions.

(3) A depositary bank that is also the payor may charge back the amount of an item to its customer's account or obtain refund in accordance with the section governing return of an item received by a payor bank for credit on its books (section 28-4-301[, Idaho Code]).

(4) The right to charge back is not affected by:

(a) previous use of a credit given for the item; or

(b) failure by any bank to exercise ordinary care with respect to the item, but a bank so failing remains liable.

(5) A failure to charge back or claim refund does not affect other rights of the bank against the customer or any other party.

(6) If credit is given in dollars as the equivalent of the value of an item payable in foreign money, the dollar amount of any charge-back or refund must be calculated on the basis of the bank-offered spot rate for the foreign

money prevailing on the day when the person entitled to the charge-back or refund learns that it will not receive payment in ordinary course.

History.

1967, ch. 161, § 4-212, p. 351; am. and redesig. 1993, ch. 288, § 30, p. 1019.

STATUTORY NOTES

Compiler's Notes.

This section was formerly compiled as § 28-4-212.

Former § 28-4-214 was amended and redesignated as § 28-4-216 by § 32 of S.L. 1993, ch. 288.

The bracketed insertion at the end of subsection (3) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Decisions Under Prior Law

Bank Custom.

A custom among banks to accept checks for collection and credit them to the depositor's accounts, reserving the right to charge them back to the depositor unless collected, was not violative of but in conformity with the bank collection act. Twin Falls Bank & Trust Co. v. Pringle, 55 Idaho 451, 43 P.2d 515 (1935).

Official Comment

1. Under current bank practice, in a major portion of cases banks make provisional settlement for items when they are first received and then await subsequent determination of whether the item will be finally paid. This is the principal characteristic of what are referred to in banking parlance as "cash items." Statistically, this practice of settling provisionally first and then awaiting final payment is justified because the vast majority of such

cash items are finally paid, with the result that in this great preponderance of cases it becomes unnecessary for the banks making the provisional settlements to make any further entries. In due course the provisional settlements become final simply with the lapse of time. However, in those cases in which the item being collected is not finally paid or if for various reasons the bank making the provisional settlement does not itself receive final payment, provision is made in subsection (a) for the reversal of the provisional settlements, charge-back of provisional credits and the right to obtain refund.

2. Various causes of a bank's not receiving final payment, with the resulting right of charge-back or refund, are stated or suggested in subsection (a). These include dishonor of the original item; dishonor of a remittance instrument given for it; reversal of a provisional credit for the item; suspension of payments by another bank. The causes stated are illustrative; the right of charge-back or refund is stated to exist whether the failure to receive final payment in ordinary course arises through one of them "or otherwise."

3. The right of charge-back or refund exists if a collecting bank has made a provisional settlement for an item with its customer but terminates if and when a settlement received by the bank for the item is or becomes final. If the bank fails to receive such a final settlement the right of charge-back or refund must be exercised promptly after the bank learns the facts. The right exists (if so promptly exercised) whether or not the bank is able to return the item. The second sentence of subsection (a) adopts the view of *Appliance Buyers Credit Corp. v. Prospect National Bank,* 708 F.2d 290 (7th Cir. 1983), that if the midnight deadline for returning an item or giving notice is not met, a collecting bank loses its rights only to the extent of damages for any loss resulting from the delay.

4. Subsection (b) states when an item is returned by a collecting bank. Regulation CC, Section 229.31 preempts this subsection with respect to checks by allowing direct return to the depositary bank. Because a returned check may follow a different path than in forward collection, settlement given for the check is final and not provisional except as between the depositary bank and its customer. Regulation CC Section 229.36(d). See also Regulations CC Sections 229.31(c) and 229.32(b). Thus owing to the federal preemption, this subsection applies only to noncheck items.

5. The rule of subsection (d) relating to charge-back (as distinguished from claim for refund) applies irrespective of the cause of the nonpayment, and of the person ultimately liable for nonpayment. Thus charge-back is permitted even if nonpayment results from the depositary bank's own negligence. Any other rule would result in litigation based upon a claim for wrongful dishonor of other checks of the customer, with potential damages far in excess of the amount of the item. Any other rule would require a bank to determine difficult questions of fact. The customer's protection is found in the general obligation of good faith (Sections 1-203 and 4-103). If bad faith is established the customer's recovery "includes other damages, if any, suffered by the party as a proximate consequence" (Section 4-103(e); see also Section 4-402).

6. It is clear that the charge-back does not relieve the bank from any liability for failure to exercise ordinary care in handling the item. The measure of damages for such failure is stated in Section 4-103(e).

7. Subsection (f) states a rule fixing the time for determining the rate of exchange if there is a charge-back or refund of a credit given in dollars for an item payable in a foreign currency. Compare Section 3-107. Fixing such a rule is desirable to avoid disputes. If in any case the parties wish to fix a different time for determining the rate of exchange, they may do so by agreement.

§ 28-4-215. Final payment of item by payor bank — When provisional debits and credits become final — When certain credits become available for withdrawal. — (1) An item is finally paid by a payor bank when the bank has first done any of the following:

(a) paid the item in cash;

(b) settled for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement; or

(c) made a provisional settlement for the item and failed to revoke the settlement in the time and manner permitted by statute, clearing-house rule or agreement.

(2) If provisional settlement for an item does not become final, the item is not finally paid.

(3) If provisional settlement for an item between the presenting and payor banks is made through a clearing house or by debits or credits in an account between them, then to the extent that provisional debits or credits for the item are entered in accounts between the presenting and payor banks or between the presenting and successive prior collecting banks seriatim, they become final upon final payment of the item by the payor bank.

(4) If a collecting bank receives a settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item and any provisional credit given for the item in an account with its customer becomes final.

(5) Subject to (i) applicable law stating a time for availability of funds and (ii) any right of the bank to apply the credit to an obligation of the customer, credit given by a bank for an item in a customer's account becomes available for withdrawal as of right:

(a) if the bank has received a provisional settlement for the item, when the settlement becomes final and the bank has had a reasonable time to receive return of the item and the item has not been received within that time;

(b) if the bank is both the depositary bank and the payor bank and the item is finally paid, at the opening of the bank's second banking day following receipt of the item.

(6) Subject to applicable law stating a time for availability of funds and any right of a bank to apply a deposit to an obligation of the depositor, a deposit of money becomes available for withdrawal as of right at the opening of the bank's next banking day after receipt of the deposit.

History.

1967, ch. 161, § 4-213, p. 351; am. and redesig. 1993, ch. 288, § 31, p. 1019.

STATUTORY NOTES

Compiler's Notes.

This section was formerly compiled as § 28-4-213.

Official Comment

1. By the definition and use of the term "settle" (Section 4-104(a)(11)) this Article recognizes that various debits or credits, remittances, settlements or payments given for an item may be either provisional or final, that settlements sometimes are provisional and sometimes are final and sometimes are provisional for awhile but later become final. Subsection (a) defines when settlement for an item constitutes final payment.

Final payment of an item is important for a number of reasons. It is one of several factors determining the relative priorities between items and notices, stop-payment orders, legal process and setoffs (Section 4-303). It is the "end of the line" in the collection process and the "turn around" point commencing the return flow of proceeds. It is the point at which many provisional settlements become final. See Section 4-215(c). Final payment of an item by the payor bank fixes preferential rights under Section 4-216.

2. If an item being collected moves through several states, e.g., is deposited for collection in California, moves through two or three California banks to the Federal Reserve Bank of San Francisco, to the Federal Reserve Bank of Boston, to a payor bank in Maine, the collection

process involves the eastward journey of the item from California to Maine and the westward journey of the proceeds from Maine to California. Subsection (a) recognizes that final payment does not take place, in this hypothetical case, on the journey of the item eastward. It also adopts the view that neither does final payment occur on the journey westward because what in fact is journeying westward are proceeds of the item.

3. Traditionally and under various decisions payment in cash of an item by a payor bank has been considered final payment. Subsection (a)(1) recognizes and provides that payment of an item in cash by a payor bank is final payment.

4. Section 4-104(a)(11) defines "settle" as meaning "to pay in cash, by clearing-house settlement, in a charge or credit or by remittance, or otherwise as agreed. A settlement may be either provisional or final." Subsection (a)(2) of Section 4-215 provides that an item is finally paid by a payor bank when the bank has "settled for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement." Former subsection (1)(b) is modified by subsection (a)(2) to make clear that a payor bank cannot make settlement provisional by unilaterally reserving a right to revoke the settlement. The right must come from a statute (e.g., Section 4-301), clearing-house rule or other agreement. Subsection (a)(2) provides in effect that if the payor bank finally settles for an item this constitutes final payment of the item. The subsection operates if nothing has occurred and no situation exists making the settlement provisional. If under statute, clearing-house rule or agreement, a right of revocation of the settlement exists, the settlement is provisional. Conversely, if there is an absence of a right to revoke under statute, clearing-house rule or agreement, the settlement is final and such final settlement constitutes final payment of the item.

A primary example of a statutory right on the part of the payor bank to revoke a settlement is the right to revoke conferred by Section 4-301. The underlying theory and reason for deferred posting statutes (Section 4-301) is to require a settlement on the date of receipt of an item but to keep that settlement provisional with the right to revoke prior to the midnight deadline. In any case in which Section 4-301 is applicable, any settlement by the payor bank is provisional solely by virtue of the statute, subsection (a)(2) of Section 4-215 does not operate, and such provisional settlement

does not constitute final payment of the item. With respect to checks, Regulation CC Section 229.36(d) provides that settlement between banks for the forward collection of checks is final. The relationship of this provision to Article 4 is discussed in the Commentary to that section.

A second important example of a right to revoke a settlement is that arising under clearing-house rules. It is very common for clearing-house rules to provide that items exchanged and settled for in a clearing (e.g., before 10:00 a.m. on Monday) may be returned and the settlements revoked up to but not later than 2:00 p.m. on the same day (Monday) or under deferred posting at some hour on the next business day (e.g., 2:00 p.m. Tuesday). Under this type of rule the Monday morning settlement is provisional and being provisional does not constitute a final payment of the item.

An example of an agreement allowing the payor bank to revoke a settlement is a case in which the payor bank is also the depositary bank and has signed a receipt or duplicate deposit ticket or has made an entry in a passbook acknowledging receipt, for credit to the account of A, of a check drawn on it by B. If the receipt, deposit ticket, passbook or other agreement with A is to the effect that any credit so entered is provisional and may be revoked pending the time required by the payor bank to process the item to determine if it is in good form and there are funds to cover it, the agreement keeps the receipt or credit provisional and avoids its being either final settlement or final payment.

The most important application of subsection (a)(2) is that in which presentment of an item has been made over the counter for immediate payment. In this case Section 4-301(a) does not apply to make the settlement provisional, and final payment has occurred unless a rule or agreement provides otherwise.

5. Former Section 4-213(1)(c) provided that final payment occurred when the payor bank completed the "process of posting." The term was defined in former Section 4-109. In the present Article, Section 4-109 has been deleted and the process-of-posting test has been abandoned in Section 4-215(a) for determining when final payment is made. Difficulties in determining when the events described in former Section 4-109 take place make the process-

of-posting test unsuitable for a system of automated check collection or electronic presentment.

6. The last sentence of former Section 4-213(1) is deleted as an unnecessary source of confusion. Initially the view that payor bank may be accountable for, that is, liable for the amount of, an item that it has already paid seems incongruous. This is particularly true in the light of the language formerly found in Section 4-302 stating that the payor bank can defend against liability for accountability by showing that it has already settled for the item. But, at least with respect to former Section 4-213(1)(c), such a provision was needed because under the process-of-posting test a payor bank may have paid an item without settling for it. Now that Article 4 has abandoned the process-of-posting test, the sentence is no longer needed. If the payor bank has neither paid the item nor returned it within its midnight deadline, the payor bank is accountable under Section 4-302.

7. Subsection (a)(3) covers the situation in which the payor bank makes a provisional settlement for an item, and this settlement becomes final at a later time by reason of the failure of the payor bank to revoke it in the time and manner permitted by statute, clearing-house rule or agreement. An example of this type of situation is the clearing-house settlement referred to in Comment 4. In the illustration there given if the time limit for the return of items received in the Monday morning clearing is 2:00 p.m. on Tuesday and the provisional settlement has not been revoked at that time in a manner permitted by the clearing-house rules, the provisional settlement made on Monday morning becomes final at 2:00 p.m. on Tuesday. Subsection (a)(3) provides specifically that in this situation the item is finally paid at 2:00 p.m. Tuesday. If on the other hand a payor bank receives an item in the mail on Monday and makes some provisional settlement for the item on Monday, it has until midnight on Tuesday to return the item or give notice and revoke any settlement under Section 4-301. In this situation subsection (a)(3) of Section 4-215 provides that if the provisional settlement made on Monday is not revoked before midnight on Tuesday as permitted by Section 4-301, the item is finally paid at midnight on Tuesday. With respect to checks, Regulation CC Section 229.30(c) allows an extension of the midnight deadline under certain circumstances. If a bank does not expeditiously return a check liability may accrue under Regulation CC Section 229.38.

For the relationship of that liability to responsibility under this Article, see Regulation CC Sections 229.30 and 229.38.

8. Subsection (b) relates final settlement to final payment under Section 4-215. For example, if a payor bank makes provisional settlement for an item by sending a cashier's or teller's check and that settlement fails to become final under Section 4-213(c), subsection (b) provides that final payment has not occurred. If the item is not paid, the drawer remains liable, and under Section 4-302(a) the payor bank is accountable unless it has returned the item before its midnight deadline. In this regard, subsection (b) is an exception to subsection (a)(3). Even if the payor bank has not returned an item by its midnight deadline there is still no final payment if provisional settlement had been made and settlement failed to become final. However, if presentment of the item was over the counter for immediate payment, final payment has occurred under Section 4-215(a)(2). Subsection (b) does not apply because the settlement was not provisional. Section 4-301(a). In this case the presenting person, often the payee of the item, has the right to demand cash or the cash equivalent of federal reserve credit. If the presenting person accepts another medium of settlement such as a cashier's or teller's check, the presenting person takes the risk that the payor bank may fail to pay a cashier's check because of insolvency or that the drawee of a teller's check may dishonor it.

9. Subsection (c) states the country-wide usage that when the item is finally paid by the payor bank under subsection (a) this final payment automatically without further action "firms up" other provisional settlements made for it. However, the subsection makes clear that this "firming up" occurs only if the settlement between the presenting and payor banks was made either through a clearing house or by debits and credits in accounts between them. It does not take place if the payor bank remits for the item by sending some form of remittance instrument. Further, the "firming up" continues only to the extent that provisional debits and credits are entered seriatim in accounts between banks which are successive to the presenting bank. The automatic "firming up" is broken at any time that any collecting bank remits for the item by sending a remittance draft, because final payment to the remittee then usually depends upon final payment of the remittance draft.

10. Subsection (d) states the general rule that if a collecting bank receives settlement for an item which is or becomes final, the bank is accountable to its customer for the amount of the item. One means of accounting is to remit to its customer the amount it has received on the item. If previously it gave to its customer a provisional credit for the item in an account its receipt of final settlement for the item "firms up" this provisional credit and makes it final. When this credit given by it so becomes final, in the usual case its agency status terminates and it becomes a debtor to its customer for the amount of the item. See Section 4-201(a). If the accounting is by a remittance instrument or authorization to charge further time will usually be required to complete its accounting (Section 4-213).

11. Subsection (e) states when certain credits given by a bank to its customer become available for withdrawal as of right. Subsection (e)(1) deals with the situation in which a bank has given a credit (usually provisional) for an item to its customer and in turn has received a provisional settlement for the item from an intermediary or payor bank to which it has forwarded the item. In this situation before the provisional credit entered by the collecting bank in the account of its customer becomes available for withdrawal as of right, it is not only necessary that the provisional settlement received by the bank for the item becomes final but also that the collecting bank has a reasonable time to receive return of the item and the item has not been received within that time. How much time is "reasonable" for these purposes will of course depend on the distance the item has to travel and the number of banks through which it must pass (having in mind not only travel time by regular lines of transmission but also the successive midnight deadlines of the several banks) and other pertinent facts. Also, if the provisional settlement received is some form of a remittance instrument or authorization to charge, the "reasonable" time depends on the identity and location of the payor of the remittance instrument, the means for clearing such instrument, and other pertinent facts. With respect to checks Regulation CC Sections 229.10-229.13 or similar applicable state law (Section 229.20) control. This is also time for the situation described in Comment 12.

12. Subsection (e)(2) deals with the situation of a bank that is both a depositary bank and a payor bank. The subsection recognizes that if A and B are both customers of a depositary-payor bank and A deposits B's check

on the depositary-payor in A's account on Monday, time must be allowed to permit the check under the deferred posting rules of Section 4-301 to reach the bookkeeper for B's account at some time on Tuesday, and, if there are insufficient funds in B's account, to reverse or charge back the provisional credit in A's account. Consequently this provisional credit in A's account does not become available for withdrawal as of right until the opening of business on Wednesday. If it is determined on Tuesday that there are insufficient funds in B's account to pay the check, the credit to A's account can be reversed on Tuesday. On the other hand if the item is in fact paid on Tuesday, the rule of subsection (e)(2) is desirable to avoid uncertainty and possible disputes between the bank and its customer as to exactly what hour within the day the credit is available.

§ 28-4-216. Insolvency and preference. — (1) If an item is in or comes into the possession of a payor or collecting bank that suspends payment and the item has not been finally paid, the item must be returned by the receiver, trustee or agent in charge of the closed bank to the presenting bank or the closed bank's customer.

(2) If a payor bank finally pays an item and suspends payments without making a settlement for the item with its customer or the presenting bank which settlement is or becomes final, the owner of the item has a preferred claim against the payor bank.

(3) If a payor bank gives or a collecting bank gives or receives a provisional settlement for an item and thereafter suspends payments, the suspension does not prevent or interfere with the settlement's becoming final if the finality occurs automatically upon the lapse of certain time or the happening of certain events.

(4) If a collecting bank receives from subsequent parties settlement for an item, which settlement is or becomes final and the bank suspends payments without making a settlement for the item with its customer which settlement is or becomes final, the owner of the item has a preferred claim against the collecting bank.

History.

1967, ch. 161, § 4-214, p. 351; am. and redesig. 1993, ch. 288, § 32, p. 1019.

STATUTORY NOTES

Compiler's Notes.

This section was formerly compiled as § 28-4-214.

Official Comment

1. The underlying purpose of the provisions of this section is not to confer upon banks, holders of items or anyone else preferential positions in the event of bank failures over general depositors or any other creditors of

the failed banks. The purpose is to fix as definitely as possible the cut-off point of time for the completion or cessation of the collection process in the case of items that happen to be in the process at the time a particular bank suspends payments. It must be remembered that in bank collections as a whole and in the handling of items by an individual bank, items go through a whole series of processes. It must also be remembered that at any particular point of time a particular bank (at least one of any size) is functioning as a depositary bank for some items, as an intermediary bank for others, as a presenting bank for still others and as a payor bank for still others, and that when it suspends payments it will have close to its normal load of items working through its various processes. For the convenience of receivers, owners of items, banks, and in fact substantially everyone concerned, it is recognized that at the particular moment of time that a bank suspends payment, a certain portion of the items being handled by it have progressed far enough in the bank collection process that it is preferable to permit them to continue the remaining distance, rather than to send them back and reverse the many entries that have been made or the steps that have been taken with respect to them. Therefore, having this background and these purposes in mind, the section states what items must be turned backward at the moment suspension intervenes and what items have progressed far enough that the collection process with respect to them continues, with the resulting necessary statement of rights of various parties flowing from this prescription of the cut-off time.

2. The rules stated are similar to those stated in the American Bankers Association Bank Collection Code, but with the abandonment of any theory of trust. On the other hand, some law previous to this Act may be relevant. See Note, Uniform Commercial Code: Stopping Payment of an Item Deposited with an Insolvent Depositary Bank, 40 Okla. L. Rev. 689 (1987). Although for practical purposes Federal Deposit Insurance affects materially the result of bank failures on holders of items and banks, no attempt is made to vary the rules of the section by reason of such insurance.

3. It is recognized that in view of *Jennings v. United States Fidelity & Guaranty Co.*, 294 U.S. 216, 55 S. Ct. 394, 79 L. Ed. 869, 99 A.L.R. 1248 (1935), amendment of the National Bank Act would be necessary to have this section apply to national banks. But there is no reason why it should not apply to others. See Section 1-108.

Part 3
Collection of Items — Payor Banks

Idaho Code § 28-4-301

§ 28-4-301. Deferred posting — Recovery of payment by return of items — Time of dishonor — Return of items by payor bank. — (1) If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover the settlement if, before it has made final payment and before its midnight deadline, it:

(a) returns the item; or

(b) sends written notice of dishonor or nonpayment if the item is unavailable for return.

(2) If a demand item is received by a payor bank for credit on its books, it may return the item or send notice of dishonor and may revoke any credit given or recover the amount thereof withdrawn by its customer, if it acts within the time limit and in the manner specified in subsection (1) of this section.

(3) Unless previous notice of dishonor has been sent, an item is dishonored at the time when for purposes of dishonor it is returned or notice sent in accordance with this section.

(4) An item is returned:

(a) as to an item presented through a clearing house, when it is delivered to the presenting or last collecting bank or to the clearing house or is sent or delivered in accordance with clearing-house rules; or

(b) in all other cases, when it is sent or delivered to the bank's customer or transferor or pursuant to instructions.

History.

1967, ch. 161, § 4-301, p. 351; am. 1993, ch. 288, § 33, p. 1019.

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 318 et seq.

Official Comment

1. The term “deferred posting” appears in the caption of Section 4-301. This refers to the practice permitted by statute in most of the states before the UCC under which a payor bank receives items on one day but does not post the items to the customer’s account until the next day. Items dishonored were then returned after the posting on the day after receipt. Under Section 4-301 the concept of “deferred posting” merely allows a payor bank that has settled for an item on the day of receipt to return a dishonored item on the next day before its midnight deadline, without regard to when the item was actually posted. With respect to checks Regulation CC Section 229.30(c) extends the midnight deadline under the UCC under certain circumstances. See the Commentary to Regulation CC Section 229.38(d) on the relationship between the UCC and Regulation CC on settlement.

2. The function of this section is to provide the circumstances under which a payor bank that has made timely settlement for an item may return the item and revoke the settlement so that it may recover any settlement made. These circumstances are: (1) the item must be a demand item other than a documentary draft; (2) the item must be presented otherwise than for immediate payment over the counter; and (3) the payor bank must return the item (or give notice if the item is unavailable for return) before its midnight deadline and before it has paid the item. With respect to checks, see Regulation CC Section 229.31(f) on notice in lieu of return and Regulation CC Section 229.33 as to the different requirement of notice of nonpayment. An instance of when an item may be unavailable for return arises under a collecting bank check retention plan under which presentment is made by a presentment notice and the item is retained by the collecting bank. Section 4-215(a)(2) provides that final payment occurs if the payor bank has settled for an item without a right to revoke the settlement under statute, clearing-house rule or agreement. In any case in which Section 4-301(a) is applicable, the payor bank has a right to revoke the settlement by statute; therefore, Section 4-215(a)(2) is inoperable, and

the settlement is provisional. Hence, if the settlement is not over the counter and the payor bank settles in a manner that does not constitute final payment, the payor bank can revoke the settlement by returning the item before its midnight deadline.

3. The relationship of Section 4-301(a) to final settlement and final payment under Section 4-215 is illustrated by the following case. Depositary Bank sends by mail an item to Payor Bank with instructions to settle by remitting a teller's check drawn on a bank in the city where Depositary Bank is located. Payor Bank sends the teller's check on the day the item was presented. Having made timely settlement, under the deferred posting provisions of Section 4-301(a), Payor Bank may revoke that settlement by returning the item before its midnight deadline. If it fails to return the item before its midnight deadline, it has finally paid the item if the bank on which the teller's check was drawn honors the check. But if the teller's check is dishonored there has been no final settlement under Section 4-213(c) and no final payment under Section 4-215(b). Since the Payor Bank has neither paid the item nor made timely return, it is accountable for the item under Section 4-302(a).

4. The time limits for action imposed by subsection (a) are adopted by subsection (b) for cases in which the payor bank is also the depositary bank, but in this case the requirement of a settlement on the day of receipt is omitted.

5. Subsection (c) fixes a base point from which to measure the time within which notice of dishonor must be given. See Section 3-503.

6. Subsection (d) leaves banks free to agree upon the manner of returning items but establishes a precise time when an item is "returned." For definition of "sent" as used in paragraphs (1) and (2) see Section 1-201(38). Obviously the subsection assumes that the item has not been "finally paid" under Section 4-215(a). If it has been, this provision has no operation.

7. The fact that an item has been paid under proposed Section 4-215 does not preclude the payor bank from asserting rights of restitution or revocation under Section 3-418. *National Savings and Trust Co. v. Park Corp.,* 722 F.2d 1303 (6th Cir. 1983), cert. denied, 466 U.S. 939 (1984), is the correct interpretation of the present law on this issue.

§ 28-4-302. Payor bank's responsibility for late return of item. — (1) If an item is presented to and received by a payor bank, the bank is accountable for the amount of:

(a) a demand item, other than a documentary draft, whether properly payable or not, if the bank, in any case in which it is not also the depositary bank, retains the item beyond midnight of the banking day of receipt without settling for it or, whether or not it is also the depositary bank, does not pay or return the item or send notice of dishonor until after its midnight deadline; or (b) any other properly payable item unless, within the time allowed for acceptance or payment of that item, the bank either accepts or pays the item or returns it and accompanying documents.

(2) The liability of a payor bank to pay an item pursuant to subsection (1) of this section is subject to defenses based on breach of a presentment warranty (section 28-4-208[, Idaho Code]) or proof that the person seeking enforcement of the liability presented or transferred the item for the purpose of defrauding the payor bank.

History.

1967, ch. 161, § 4-302, p. 351; am. 1993, ch. 288, § 34, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in subsection (2) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Purpose.

Settlement.

Time when presented.

Purpose.

Although a data processing center performs some of the routine accounting steps for more than one branch, this does not destroy the essential character of the transaction: that the one branch acted as a collecting and presenting bank for an item only another office could pay, and the legislature has expressly stated in § 28-4-106 its intent that the separateness of branch banks be respected in computing the midnight deadline, even where some of the branch's duties are performed outside the branch. Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

Settlement.

The failure of this section to specify final or provisional settlement indicates that either will suffice to effect "settlement." Idah-Best, Inc. v. First Sec. Bank, N.A., 101 Idaho 402, 614 P.2d 425 (1980).

The rather perfunctory provisional settlement helps to assure the speedy and orderly handling of checks by provisionally shifting credit for a check immediately; this section states a deadline before which this action must be taken, but it does not state that settlement may not take place before receipt. Idah-Best, Inc. v. First Sec. Bank, N.A., 101 Idaho 402, 614 P.2d 425 (1980).

Time When Presented.

It cannot be said that respondent's check was presented on the payor bank, the Hailey branch, when the check arrived at the Boise data processing center, rather, it was presented when it arrived at the Hailey office with the indorsements of all previous transferors (including the Boise branch) as the culmination of the collection process. Idah-Best, Inc. v. First Sec. Bank, 99 Idaho 517, 584 P.2d 1242 (1978).

Cited Chenery v. Agri-Lines Corp., 106 Idaho 687, 682 P.2d 640 (Ct. App. 1984).

Official Comment

1. Subsection (a)(1) continues the former law distinguishing between cases in which the payor bank is not also the depositary bank and those in

which the payor bank is also the depositary bank ("on us" items). For "on us" items the payor bank is accountable if it retains the item beyond its midnight deadline without settling for it. If the payor bank is not the depositary bank it is accountable if it retains the item beyond midnight of the banking day of receipt without settling for it. It may avoid accountability either by settling for the item on the day of receipt and returning the item before its midnight deadline under Section 4-301 or by returning the item on the day of receipt. This rule is consistent with the deferred posting practice authorized by Section 4-301 which allows the payor bank to make provisional settlement for an item on the day of receipt and to revoke that settlement by returning the item on the next day. With respect to checks, Regulation CC Section 229.36(d) provides that settlements between banks for forward collection of checks are final when made. See the Commentary on that provision for its effect on the UCC.

2. If the settlement given by the payor bank does not become final, there has been no payment under Section 4-215(b), and the payor bank giving the failed settlement is accountable under subsection (a)(1) of Section 4-302. For instance, the payor bank makes provisional settlement by sending a teller's check that is dishonored. In such a case settlement is not final under Section 4-213(c) and no payment occurs under Section 4-215(b). Payor bank is accountable on the item. The general principle is that unless settlement provides the presenting bank with usable funds, settlement has failed and the payor bank is accountable for the amount of the item. On the other hand, if the payor bank makes a settlement for the item that becomes final under Section 4-215, the item has been paid and thus the payor bank is not accountable for the item under this Section.

3. Subsection (b) is an elaboration of the deleted introductory language of former Section 4-302: "In the absence of a valid defense such as breach of a presentment warranty (subsection (1) of Section 4-207), settlement effected or the like . . . ." A payor bank can defend an action against it based on accountability by showing that the item contained a forged indorsement or a fraudulent alteration. Subsection (b) drops the ambiguous "or the like" language and provides that the payor bank may also raise the defense of fraud. Decisions that hold an accountable bank's liability to be "absolute" are rejected. A payor bank that makes a late return of an item should not be liable to a defrauder operating a check kiting scheme. In *Bank of Leumi*

Trust Co. v. Bally's Park Place Inc., 528 F. Supp. 349 (S.D.N.Y. 1981), and *American National Bank v. Foodbasket,* 497 P.2d 546 (Wyo. 1972), banks that were accountable under Section 4-302 for missing their midnight deadline were successful in defending against parties who initiated collection knowing that the check would not be paid. The "settlement effected" language is deleted as unnecessary. If a payor bank is accountable for an item it is liable to pay it. If it has made final payment for an item, it is no longer accountable for the item.

§ 28-4-303. When items subject to notice, stop-payment order, legal process or setoff — Order in which items may be charged or certified. — (1) Any knowledge, notice or stop-payment order received by, legal process served upon, or setoff exercised by a payor bank comes too late to terminate, suspend or modify the bank's right or duty to pay an item or to charge its customer's account for the item if the knowledge, notice, stop-payment order, or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised after the earliest of the following:

(a) the bank accepts or certifies the item;

(b) the bank pays the item in cash;

(c) the bank settles for the item without having a right to revoke the settlement under statute, clearing-house rule or agreement;

(d) the bank becomes accountable for the amount of the item under section 28-4-302[, Idaho Code,] dealing with the payor bank's responsibility for late return of items; or

(e) with respect to checks, a cutoff hour no earlier than one (1) hour after the opening of the next banking day after the banking day on which the bank received the check and no later than the close of that next banking day or, if no cutoff hour is fixed, the close of the next banking day after the banking day on which the bank received the check.

(2) Subject to the provisions of subsection (1) of this section items may be accepted, paid, certified or charged to the indicated account of its customer in any order.

History.

1967, ch. 161, § 4-303, p. 351; am. 1993, ch. 288, § 35, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in paragraph (1)(d) was added by the compiler to conform to the statutory citation style.

Official Comment

1. While a payor bank is processing an item presented for payment, it may receive knowledge or a legal notice affecting the item, such as knowledge or a notice that the drawer has filed a petition in bankruptcy or made an assignment for the benefit of creditors; may receive an order of the drawer stopping payment on the item; may have served on it an attachment of the account of the drawer; or the bank itself may exercise a right of setoff against the drawer's account. Each of these events affects the account of the drawer and may eliminate or freeze all or part of whatever balance is available to pay the item. Subsection (a) states the rule for determining the relative priorities between these various legal events and the item.

2. The rule is that if any one of several things has been done to the item or if it has reached any one of several stages in its processing at the time the knowledge, notice, stop-payment order or legal process is received or served and a reasonable time for the bank to act thereon expires or the setoff is exercised, the knowledge, notice, stop-payment order, legal process or setoff comes too late, the item has priority and a charge to the customer's account may be made and is effective. With respect to the effect of the customer's bankruptcy, the bank's rights are governed by Bankruptcy Code Section 542(c) which codifies the result of *Bank of Marin v. England,* 385 U.S. 99 (1966). Section 4-405 applies to the death or incompetence of the customer.

3. Once a payor bank has accepted or certified an item or has paid the item in cash, the event has occurred that determines priorities between the item and the various legal events usually described as the "four legals." Paragraphs (1) and (2) of subsection (a) so provide. If a payor bank settles for an item presented over the counter for immediate payment by a cashier's check or teller's check which the presenting person agrees to accept, paragraph (3) of subsection (a) would control and the event determining priority has occurred. Because presentment was over the counter, Section 4-301(a) does not apply to give the payor bank the statutory right to revoke

the settlement. Thus the requirements of paragraph (3) have been met unless a clearing-house rule or agreement of the parties provides otherwise.

4. In the usual case settlement for checks is by entries in bank accounts. Since the process-of-posting test has been abandoned as inappropriate for automated check collection, the determining event for priorities is a given hour on the day after the item is received. (Paragraph (5) of subsection (a).) The hour may be fixed by the bank no earlier than one hour after the opening on the next banking day after the bank received the check and no later than the close of that banking day. If an item is received after the payor bank's regular Section 4-108 cutoff hour, it is treated as received the next banking day. If a bank receives an item after its regular cutoff hour on Monday and an attachment is levied at noon on Tuesday, the attachment is prior to the item if the bank had not before that hour taken the action described in paragraphs (1), (2), and (3) of subsection (a). The Commentary to Regulation CC Section 229.36(d) explains that even though settlement by a paying bank for a check is final for Regulation CC purposes, the paying bank's right to return the check before its midnight deadline under the UCC is not affected.

5. Another event conferring priority for an item and a charge to the customer's account based upon the item is stated by the language "become accountable for the amount of the item under Section 4-302 dealing with the payor bank's responsibility for late return of items." Expiration of the deadline under Section 4-302 with resulting accountability by the payor bank for the amount of the item, establishes priority of the item over notices, stop-payment orders, legal process or setoff.

6. In the case of knowledge, notice, stop-payment orders and legal process the effective time for determining whether they were received too late to affect the payment of an item and a charge to the customer's account by reason of such payment, is receipt plus a reasonable time for the bank to act on any of these communications. Usually a relatively short time is required to communicate to the accounting department advice of one of these events but certainly some time is necessary. Compare Sections 1-201(27) and 4-403. In the case of setoff the effective time is when the setoff is actually made.

7. As between one item and another no priority rule is stated. This is justified because of the impossibility of stating a rule that would be fair in all cases, having in mind the almost infinite number of combinations of large and small checks in relation to the available balance on hand in the drawer’s account; the possible methods of receipt; and other variables. Further, the drawer has drawn all the checks, the drawer should have funds available to meet all of them and has no basis for urging one should be paid before another; and the holders have no direct right against the payor bank in any event, unless of course, the bank has accepted, certified or finally paid a particular item, or has become liable for it under Section 4-302. Under subsection (b) the bank has the right to pay items for which it is itself liable ahead of those for which it is not.

Part 4
Relationship Between Payor Bank and Its Customer

• Title 28 •, « Ch. 4 », « Pt. 4 », • § 28-4-401 »

§ 28-4-401. When bank may charge customer's account. — (1) A bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft. An item is properly payable if it is authorized by the customer and is in accordance with any agreement between the customer and the bank.

(2) A customer is not liable for the amount of an overdraft if the customer neither signed the item nor benefited from the proceeds of the item.

(3) A bank may charge against the account of a customer a check that is otherwise properly payable from the account, even though payment was made before the date of the check, unless the customer has given notice to the bank of the postdating describing the check with reasonable certainty. The notice is effective for the period stated in section 28-4-403(2)[, Idaho Code,] for stop-payment orders, and must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it before the bank takes any action with respect to the check described in section 28-4-303[, Idaho Code]. If a bank charges against the account of a customer a check before the date stated in the notice of postdating, the bank is liable for damages for the loss resulting from its act. The loss may include damages for dishonor of subsequent items under section 28-4-402[, Idaho Code].

(4) A bank that in good faith makes payment to a holder may charge the indicated account of its customer according to: (a) the original terms of the altered item; or (b) the terms of the completed item, even though the bank knows the item has been completed unless the bank has notice that the completion was improper.

History.

1967, ch. 161, § 4-401, p. 351; am. 1993, ch. 288, § 36, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (3) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Indorsement.

— Authorized.

Where unauthorized agent of Colorado company wrongfully obtained funds via check to said company from purchasers in return for merchandise which alleged agent indicated he had authority to sell, and where alleged agent did not impersonate anyone, but merely represented that he was the authorized agent of Colorado company, purchasers were entitled to have the authorized indorsement of Colorado company before the check was charged against their account, and bank upon which check was drawn was not entitled to charge the purchasers' account for the check that alleged agent indorsed as agent of said company where indorsement was not authorized. Valley Bank v. Monarch Inv. Co., 118 Idaho 747, 800 P.2d 634 (1990).

Despite a bank's contention that §§ 26-717, 28-4-401, and 68-309, taken together, dictate that only the owner of a bank account may assert a legally cognizable interest in a deposit account, the statutes did not resolve the rights of the account owner in relation to the bankruptcy debtor, the true owner of the funds deposited in that account; thus the use of account funds to pay a debt of the account owner was a transfer of the debtor's property which was avoidable in bankruptcy. Hopkins v. D.L. Evans Bank (In re Fox Bean Co.), 287 B.R. 270 (Bankr. D. Idaho 2002).

— Forged.

Between a bank and its customer, the bank must bear losses resulting from payment of a customer's check based on a forged indorsement. Valley

Bank v. Monarch Inv. Co., 118 Idaho 747, 800 P.2d 634 (1990).

Official Comment

1. An item is properly payable from a customer's account if the customer has authorized the payment and the payment does not violate any agreement that may exist between the bank and its customer. For an example of a payment held to violate an agreement with a customer, see *Torrance National Bank v. Enesco Federal Credit Union,* 285 P.2d 737 (Cal. App. 1955). An item drawn for more than the amount of a customer's account may be properly payable. Thus under subsection (a) a bank may charge the customer's account for an item even though payment results in an overdraft. An item containing a forged drawer's signature or forged indorsement is not properly payable. Concern has arisen whether a bank may require a customer to execute a stop-payment order when the customer notifies the bank of the loss of an unindorsed or specially indorsed check. Since such a check cannot be properly payable from the customer's account, it is inappropriate for a bank to require stop-payment order in such a case.

2. Subsection (b) adopts the view of case authority holding that if there is more than one customer who can draw on an account, the nonsigning customer is not liable for an overdraft unless that person benefits from the proceeds of the item.

3. Subsection (c) is added because the automated check collection system cannot accommodate postdated checks. A check is usually paid upon presentment without respect to the date of the check. Under the former law, if a payor bank paid a postdated check before its stated date, it could not charge the customer's account because the check was not "properly payable." Hence, the bank might have been liable for wrongfully dishonoring subsequent checks of the drawer that would have been paid had the postdated check not been prematurely paid. Under subsection (c) a customer wishing to postdate a check must notify the payor bank of its postdating in time to allow the bank to act on the customer's notice before the bank has to commit itself to pay the check. If the bank fails to act on the customer's timely notice, it may be liable for damages for the resulting loss which may include damages for dishonor of subsequent items. This Act does not regulate fees that banks charge their customers for a notice of

postdating or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. *Perdue v. Crocker National Bank,* 38 Cal.3d 913 (1985) (unconscionability); *Best v. United Bank of Oregon,* 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 provides that every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

4. Section 3-407(c) states that a payor bank or drawee which pays a fraudulently altered instrument in good faith and without notice of the alteration may enforce rights with respect to the instrument according to its original terms or, in the case of an incomplete instrument altered by unauthorized completion, according to its terms as completed. Section 4-401(d) follows the rule stated in Section 3-407(c) by applying it to an altered item and allows the bank to enforce rights with respect to the altered item by charging the customer's account.

§ 28-4-402. Bank's liability to customer for wrongful dishonor — Time of determining insufficiency of account. — (1) Except as otherwise provided in this chapter, a payor bank wrongfully dishonors an item if it dishonors an item that is properly payable, but a bank may dishonor an item that would create an overdraft unless it has agreed to pay the overdraft.

(2) A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. Liability is limited to actual damages proved and may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

(3) A payor bank's determination of the customer's account balance on which a decision to dishonor for insufficiency of available funds is based may be made at any time between the time the item is received by the payor bank and the time that the payor bank returns the item or gives notice in lieu of return, and no more than one (1) determination need be made. If, at the election of the payor bank, a subsequent balance determination is made for the purpose of reevaluating the bank's decision to dishonor the item, the account balance at that time is determinative of whether a dishonor for insufficiency of available funds is wrongful.

History.

1967, ch. 161, § 4-402, p. 351; am. 1993, ch. 288, § 37, p. 1019.

CASE NOTES

Damages.

Where bank's customer introduces evidence that damages were proximately caused by the bank's wrongful dishonor of customer's check and jury finds by a preponderance of the evidence that customer's injury was proximate result of bank's wrongful dishonor, it should award such damages as it determines by its sound discretion and dispassionate judgment, rather than determining an exact dollar amount. Yacht Club Sales & Serv., Inc. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

— Trader Rule Inapplicable.

The common law "trader rule," under which a plaintiff is allowed to recover substantial damages for wrongful dishonor of merchant or trader's checks without proof of actual injury, does not apply to an action brought under this section; thus, plaintiff is required to prove the particular amount of damages for harm to its credit and business standing. Yacht Club Sales & Serv., Inc. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

Intentional Dishonor.

Where it was uncontroverted that bank intentionally dishonored eight of plaintiff's checks under the belief that it was legally entitled to do so, the action cannot be classified as simply a mistaken dishonor, since that term means an unintentional dishonor; thus, the trial court did not err in refusing to instruct the jury that when a bank dishonors a check by mistake its damages are limited to actual proven damages, even though this is a correct statement of the law under this section. Yacht Club Sales & Serv., Inc. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

Punitive Damages.

Although this section does not expressly allow for awards of punitive damages for wrongful dishonor of a check, Idaho case law, which allows recovery for punitive damages in tort or contract actions, can be applied to §§ 28-1-103 through 28-1-106 and this section; thus, where record shows that hold was placed on plaintiff's bank account with no prior consultation by bank with its attorney, and with no inquiry or notice by bank to plaintiff, there was sufficient evidence to justify submission of the issue to the jury under either a contract or tort theory. Yacht Club Sales & Serv., Inc. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

Wrongful Dishonor.

Where jury's award of damages was based solely on the first series of checks which trial court held had been wrongfully dishonored as a matter of law, trial court's instruction to the jury on the definition of negligence, which is inapplicable to wrongful dishonor, was harmless error. Yacht Club Sales & Serv., Inc. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

Cited First Piedmont Bank & Trust Co. v. Doyle, 97 Idaho 700, 551 P.2d 1336 (1976).

RESEARCH REFERENCES

ALR. — What constitutes wrongful dishonor of check rendering payor bank liable to drawer under UCC § 4-402. 88 A.L.R.4th 568.

Official Comment

1. Subsection (a) states positively what has been assumed under the original Article: that if a bank fails to honor a properly payable item it may be liable to its customer for wrongful dishonor. Under subsection (b) the payor bank's wrongful dishonor of an item gives rise to a statutory cause of action. Damages may include consequential damages. Confusion has resulted from the attempts of courts to reconcile the first and second sentences of former Section 4-402. The second sentence implied that the bank was liable for some form of damages other than those proximately caused by the dishonor if the dishonor was other than by mistake. But nothing in the section described what these noncompensatory damages might be. Some courts have held that in distinguishing between mistaken dishonors and nonmistaken dishonors, the so-called "trader" rule has been retained that allowed a "merchant or trader" to recover substantial damages for wrongful dishonor without proof of damages actually suffered. Comment 3 to former Section 4-402 indicated that this was not the intent of the drafters. White & Summers, Uniform Commercial Code, Section 18-4 (1988), states: "The negative implication is that when wrongful dishonors occur not 'through mistake' but willfully, the court may impose damages greater than 'actual damages' . . . . Certainly the reference to 'mistake' in the second sentence of 4-402 invites a court to adopt the relevant pre-Code distinction." Subsection (b) by deleting the reference to mistake in the

second sentence precludes any inference that Section 4-402 retains the "trader" rule. Whether a bank is liable for noncompensatory damages, such as punitive damages, must be decided by Section 1-103 and Section 1-106 ("by other rule of law").

2. Wrongful dishonor is different from "failure to exercise ordinary care in handling an item," and the measure of damages is that stated in this section, not that stated in Section 4-103(e). By the same token, if a dishonor comes within this section, the measure of damages of this section applies and not another measure of damages. If the wrongful refusal of the beneficiary's bank to make funds available from a funds transfer causes the beneficiary's check to be dishonored, no specific guidance is given as to whether recovery is under this section or Article 4A. In each case this issue must be viewed in its factual context, and it was thought unwise to seek to establish certainty at the cost of fairness.

3. The second and third sentences of the subsection (b) reject decisions holding that as a matter of law the dishonor of a check is not the "proximate cause" of the arrest and prosecution of the customer and leave to determination in each case as a question of fact whether the dishonor is or may be the "proximate cause."

4. Banks commonly determine whether there are sufficient funds in an account to pay an item after the close of banking hours on the day of presentment when they post debit and credit items to the account. The determination is made on the basis of credits available for withdrawal as of right or made available for withdrawal by the bank as an accommodation to its customer. When it is determined that payment of the item would overdraw the account, the item may be returned at any time before the bank's midnight deadline the following day. Before the item is returned new credits that are withdrawable as of right may have been added to the account. Subsection (c) eliminates uncertainty under Article 4 as to whether the failure to make a second determination before the item is returned on the day following presentment is a wrongful dishonor if new credits were added to the account on that day that would have covered the amount of the check.

5. Section 4-402 has been construed to preclude an action for wrongful dishonor by a plaintiff other than the bank's customer. *Loucks v.*

Albuquerque National Bank, 418 P.2d 191 (N. Mex. 1966). Some courts have allowed a plaintiff other than the customer to sue when the customer is a business entity that is one and the same with the individual or individuals operating it *Murdaugh Volkswagen, Inc. v. First National Bank,* 801 F.2d 719 (4th Cir. 1986) and *Karsh v. American City Bank,* 113 Cal. App. 3d 419, 169 Cal. Rptr. 851 (1980). However, where the wrongful dishonor impugns the reputation of an operator of the business, the issue is not merely, as the court in *Koger v. East First National Bank,* 443 So.2d 141 (Fla. App. 1983), put it, one of a literal versus a liberal interpretation of Section 4-402. Rather the issue is whether the statutory cause of action in Section 4-402 displaces, in accordance with Section 1-103, any cause of action that existed at common law in a person who is not the customer whose reputation was damaged. See *Marcum v. Security Trust and Savings Co.,* 221 Ala. 419, 129 So. 74 (1930). While Section 4-402 should not be interpreted to displace the latter cause of action, the section itself gives no cause of action to other than a "customer," however that definition is construed, and thus confers no cause of action on the holder of a dishonored item. *First American National Bank v. Commerce Union Bank,* 692 S.W.2d 642 (Tenn. App. 1985).

§ 28-4-403. Customer's right to stop payment — Burden of proof of loss. — (1) A customer or any person authorized to draw on the account if there is more than one (1) person may stop payment of any item drawn on the customer's account or close the account by an order to the bank describing the item or account with reasonable certainty received at a time and in a manner that affords the bank a reasonable opportunity to act on it before any action by the bank with respect to the item described in section 28-4-303[, Idaho Code]. If the signature of more than one (1) person is required to draw on an account, any of these persons may stop payment or close the account.

(2) A stop-payment order is effective for six (6) months, but it lapses after fourteen (14) calendar days if the original order was oral and was not confirmed in writing within that period. A stop-payment order may be renewed for additional six (6) month periods by a writing given to the bank within a period during which the stop-payment order is effective.

(3) The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop-payment order or order to close an account is on the customer. The loss from payment of an item contrary to a stop-payment order may include damages for dishonor of subsequent items under section 28-4-402[, Idaho Code].

History.

1967, ch. 161, § 4-403, p. 351; am. 1993, ch. 288, § 38, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsections (1) and (3) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Failure to Issue Order.

In bank's action against guarantor of corporate debts to recover amounts allegedly owed by corporation, bank's honoring of check written by former officer of corporation did not constitute a setoff defense to guarantor, where corporation had never ordered bank to stop payment on the check and where corporation never complained of damage by bank's honoring of check with unauthorized signature. First Piedmont Bank & Trust Co. v. Doyle, 97 Idaho 700, 551 P.2d 1336 (1976), overruled on other grounds, Yacht Club Sales & Serv. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

Revocation of Signatory Authority.

The revocation of authority to execute checks was not a countermand to a previous payment order and, therefore, not a stop payment order; thus, the bank did not lack good faith in honoring check written by former employee of depositor-corporation, where depositor's only request was that bank strike the signature of an officer from corporation's checking account signature card. First Piedmont Bank & Trust Co. v. Doyle, 97 Idaho 700, 551 P.2d 1336 (1976), overruled on other grounds, Yacht Club Sales & Serv. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

RESEARCH REFERENCES

ALR. — Construction and effect of UCC § 4-403(2) regulating oral or written nature of stop-payment order. 29 A.L.R.4th 228.

Official Comment

1. The position taken by this section is that stopping payment or closing an account is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure to stop or close should be borne by the banks as a cost of the business of banking.

2. Subsection (a) follows the decisions holding that a payee or indorsee has no right to stop payment. This is consistent with the provision governing payment or satisfaction. See Section 3-602. The sole exception to

this rule is found in Section 4-405 on payment after notice of death, by which any person claiming an interest in the account can stop payment.

3. Payment is commonly stopped only on checks; but the right to stop payment is not limited to checks, and extends to any item payable by any bank. If the maker of a note payable at a bank is in a position analogous to that of a drawer (Section 4-106) the maker may stop payment of the note. By analogy the rule extends to drawees other than banks.

4. A cashier's check or teller's check purchased by a customer whose account is debited in payment for the check is not a check drawn on the customer's account within the meaning of subsection (a); hence, a customer purchasing a cashier's check or teller's check has no right to stop payment of such a check under subsection (a). If a bank issuing a cashier's check or teller's check refuses to pay the check as an accommodation to its customer or for other reasons, its liability on the check is governed by Section 3-411. There is no right to stop payment after certification of a check or other acceptance of a draft, and this is true no matter who procures the certification. See Sections 3-411 and 4-303. The acceptance is the drawee's own engagement to pay, and it is not required to impair its credit by refusing payment for the convenience of the drawer.

5. Subsection (a) makes clear that if there is more than one person authorized to draw on a customer's account any one of them can stop payment of any check drawn on the account or can order the account closed. Moreover, if there is a customer, such as a corporation, that requires its checks to bear the signatures of more than one person, any of these persons may stop payment on a check. In describing the item, the customer, in the absence of a contrary agreement, must meet the standard of what information allows the bank under the technology then existing to identify the item with reasonable certainty.

6. Under subsection (b), a stop-payment order is effective after the order, whether written or oral, is received by the bank and the bank has a reasonable opportunity to act on it. If the order is written it remains in effect for six months from that time. If the order is oral it lapses after 14 days unless there is written confirmation. If there is written confirmation within the 14-day period, the six-month period dates from the giving of the oral order. A stop-payment order may be renewed any number of times by

written notice given during a six-month period while a stop order is in effect. A new stop-payment order may be given after a six-month period expires, but such a notice takes effect from the date given. When a stop-payment order expires it is as though the order had never been given, and the payor bank may pay the item in good faith under Section 4-404 even though a stop-payment order had once been given.

7. A payment in violation of an effective direction to stop-payment is an improper payment, even though it is made by mistake or inadvertence. Any agreement to the contrary is invalid under Section 4-103(a) if in paying the item over the stop-payment order the bank has failed to exercise ordinary care. An agreement to the contrary which is imposed upon a customer as part of a standard form contract would have to be evaluated in the light of the general obligation of good faith. Sections 1-203 and 4-104(c). The drawee is, however, entitled to subrogation to prevent unjust enrichment (Section 4-407); retains common law defenses, e.g., that by conduct in recognizing the payment the customer has ratified the bank's action in paying over a stop-payment order (Section 1-103); and retains common law rights, e.g., to recover money paid under a mistake under Section 3-418. It has sometimes been said that payment cannot be stopped against a holder in due course, but the statement is inaccurate. The payment can be stopped but the drawer remains liable on the instrument to the holder in due course (Sections 3-305, 3-414) and the drawee, if it pays, becomes subrogated to the rights of the holder in due course against the drawer. Section 4-407. The relationship between Sections 4-403 and 4-407 is discussed in the Comments to Section 4-407. Any defenses available against a holder in due course remain available to the drawer, but other defenses are cut off to the same extent as if the holder were bringing the action.

§ 28-4-404. Bank not obligated to pay check more than six months old. — A bank is under no obligation to a customer having a checking account to pay a check, other than a certified check, which is presented more than six (6) months after its date, but it may charge its customer's account for a payment made thereafter in good faith.

History.

1967, ch. 161, § 4-404, p. 351.

Official Comment

This section incorporates a type of statute that had been adopted in twenty-six jurisdictions before the Code. The time limit is set at six months because banking and commercial practice regards a check outstanding for longer than that period as stale, and a bank will normally not pay such a check without consulting the depositor. It is therefore not required to do so, but is given the option to pay because it may be in a position to know, as in the case of dividend checks, that the drawer wants payment made.

Certified checks are excluded from the section because they are the primary obligation of the certifying bank (Sections 3-409 and 3-413). The obligation runs directly to the holder of the check. The customer's account was presumably charged when the check was certified.

§ 28-4-404A. Bank shall provide notice of use of photocopy check. — In the event the original copy of a check is lost or mutilated during processing by a bank, and if a photocopy of a check is presented for payment, and the bank honors the photocopy for payment, the bank shall prepare a notice to its customer, which shall be forwarded to the customer with the monthly statement of accounts.

History.

I.C., § 28-4-404A, as added by 1984, ch. 145, § 1, p. 340.

§ 28-4-404B. Statutory form for notice of processing photocopied check. — The notice of a photocopied check required by section 28-4-404A, Idaho Code, shall be imprinted on the jacket containing the photocopied check or the facsimile itself and the notice shall be substantially in the following form:

NOTICE OF PROCESSING OF PHOTOCOPIED CHECK.

A check drawn by you has been photocopied and the photocopy has been honored. The original of the check has been lost or mutilated, and the photocopy has been used for your convenience. We have attempted to insure that payment has been made only one time. This is your notice of this process so that you may check your statement of account to determine that payment has not been duplicated.

History.

I.C., § 28-4-404B, as added by 1984, ch. 145, § 2, p. 340.

§ 28-4-404C. When notice not required. — The notice required by section 28-4-404B, Idaho Code, shall not be required in the event that the customer has elected to have the bank hold checks.

History.

I.C., § 28-4-404C, as added by 1984, ch. 145, § 3, p. 340.

§ 28-4-405. Death or incompetence of customer. — (1) A payor or collecting bank's authority to accept, pay or collect an item or to account for proceeds of its collection, if otherwise effective, is not rendered ineffective by incompetence of a customer of either bank existing at the time the item is issued or its collection is undertaken if the bank does not know of an adjudication of incompetence. Neither death nor incompetence of a customer revokes the authority to accept, pay, collect or account until the bank knows of the fact of death or of an adjudication of incompetence and has reasonable opportunity to act on it.

(2) Even with knowledge, a bank may for ten (10) days after the date of death pay or certify checks drawn on or before that date unless ordered to stop payment by a person claiming an interest in the account.

History.

1967, ch. 161, § 4-405, p. 351; am. 1993, ch. 288, § 39, p. 1019.

Official Comment

1. Subsection (a) follows existing decisions holding that a drawee (payor) bank is not liable for the payment of a check before it has notice of the death or incompetence of the drawer. The justice and necessity of the rule are obvious. A check is an order to pay which the bank must obey under penalty of possible liability for dishonor. Further, with the tremendous volume of items handled any rule that required banks to verify the continued life and competency of drawers would be completely unworkable.

One or both of these same reasons apply to other phases of the bank collection and payment process and the rule is made wide enough to apply to these other phases. It applies to all kinds of "items"; to "customers" who own items as well as "customers" who draw or make them; to the function of collecting items as well as the function of accepting or paying them; to the carrying out of instructions to account for proceeds even though these may involve transfers to third parties; to depositary and intermediary banks

as well as payor banks; and to incompetency existing at the time of the issuance of an item or the commencement of the collection or payment process as well as to incompetency occurring thereafter. Further, the requirement of actual knowledge makes inapplicable the rule of some cases that an adjudication of incompetency is constructive notice to all the world because obviously it is as impossible for banks to keep posted on such adjudications (in the absence of actual knowledge) as it is to keep posted as to death of immediate or remote customers.

2. Subsection (b) provides a limited period after death during which a bank may continue to pay checks (as distinguished from other items) even though it has notice. The purpose of the provision, as of the existing statutes, is to permit holders of checks drawn and issued shortly before death to cash them without the necessity of filing a claim in probate. The justification is that these checks normally are given in immediate payment of an obligation, that there is almost never any reason why they should not be paid, and that filing in probate is a useless formality, burdensome to the holder, the executor, the court and the bank.

This section does not prevent an executor or administrator from recovering the payment from the holder of the check. It is not intended to affect the validity of any gift causa mortis or other transfer in contemplation of death, but merely to relieve the bank of liability for the payment.

3. Any surviving relative, creditor or other person who claims an interest in the account may give a direction to the bank not to pay checks, or not to pay a particular check. Such notice has the same effect as a direction to stop payment. The bank has no responsibility to determine the validity of the claim or even whether it is “colorable.” But obviously anyone who has an interest in the estate, including the person named as executor in a will, even if the will has not yet been admitted to probate, is entitled to claim an interest in the account.

§ 28-4-406. Customer's duty to discover and report unauthorized signature or alteration. — (1) A bank that sends or makes available to a customer a statement of account showing payment of items for the account shall either return or make available to the customer the items paid or provide information in the statement of account sufficient to allow the customer reasonably to identify the items paid. The statement of account provides sufficient information if the item is described by item number, amount, and date of payment.

(2) If the items are not returned to the customer, the person retaining the items shall either retain the items or, if the items are destroyed, maintain the capacity to furnish legible copies of the items until the expiration of seven (7) years after receipt of the items. A customer may request an item from the bank that paid the item, and that bank must provide in a reasonable time either the item or, if the item has been destroyed or is not otherwise obtainable, a legible copy of the item.

(3) If a bank sends or makes available a statement of account or items pursuant to subsection (1) of this section, the customer must exercise reasonable promptness in examining the statement or the items to determine whether any payment was not authorized because of an alteration of an item or because a purported signature by or on behalf of the customer was not authorized. If, based on the statement or items provided, the customer should reasonably have discovered the unauthorized payment, the customer must promptly notify the bank of the relevant facts.

(4) If the bank proves that the customer failed, with respect to an item, to comply with the duties imposed on the customer by subsection (3) of this section the customer is precluded from asserting against the bank:

(a) the customer's unauthorized signature or any alteration on the item, if the bank also proves that it suffered a loss by reason of the failure; and

(b) the customer's unauthorized signature or alteration by the same wrongdoer on any other item paid in good faith by the bank if the payment was made before the bank received notice from the customer of the unauthorized signature or alteration and after the customer had been

afforded a reasonable period of time, not exceeding thirty (30) days, in which to examine the item or statement of account and notify the bank.

(5) If subsection (4) of this section applies and the customer proves that the bank failed to exercise ordinary care in paying the item and that the failure substantially contributed to loss, the loss is allocated between the customer precluded and the bank asserting the preclusion according to the extent to which the failure of the customer to comply with subsection (3) of this section and the failure of the bank to exercise ordinary care contributed to the loss. If the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (4) of this section does not apply.

(6) Without regard to care or lack of care of either the customer or the bank, a customer who does not within one (1) year after the statement or items are made available to the customer (subsection (1)) discover and report the customer's unauthorized signature on or any alteration on the item is precluded from asserting against the bank the unauthorized signature or alteration. If there is a preclusion under this subsection, the payor bank may not recover for breach of warranty under section 28-4-208[, Idaho Code,] with respect to the unauthorized signature or alteration to which the preclusion applies.

History.

1967, ch. 161, § 4-406, p. 351; am. 1993, ch. 288, § 40, p. 1019.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in the last sentence in subsection (6) was added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Failure to report unauthorized signature.

Instructions.

Liability for alteration.

Negligence.

Ordinary care.

Failure to Report Unauthorized Signature.

In bank's action against guarantor of corporate debts to recover amounts allegedly owed by corporation, bank's honoring of check written by former officer of corporation did not constitute a setoff defense to guarantor, where corporation had never ordered bank to stop payment on the check and where corporation never complained of damage by bank's honoring of check with unauthorized signature. First Piedmont Bank & Trust Co. v. Doyle, 97 Idaho 700, 551 P.2d 1336 (1976), overruled on other grounds, Yacht Club Sales & Serv. v. First Nat'l Bank, 101 Idaho 852, 623 P.2d 464 (1980).

Instructions.

In action against a bank for payment of forged checks, failure of court to give instruction that negligence, if any, on the part of bank customer may not be considered if the bank failed to utilize ordinary care in the paying of the checks, was not erroneous, where substance of such instruction was covered in given instruction that was a verbatim quote from this section. Basterrechea Distrib., Inc. v. Idaho State Bank, 122 Idaho 572, 836 P.2d 518 (1992).

Liability for Alteration.

Where the evidence, in an action by a corporate depositor against the drawee bank to have the corporation's account credited for forged checks paid by the bank, supported the finding that the depositor was not negligent in contributing to the forgeries, the drawee bank was liable to the depositor for amounts paid on the checks which were forged by manually tracing a facsimile signature from another corporate check, even though the corporation had authorized the bank to pay checks which were impressed with a facsimile signature, because placing a traced signature on the checks was not the same as mechanically impressing the signature on the checks. Mercantile Stores Co. v. Idaho First Nat'l Bank, 102 Idaho 820, 641 P.2d 1007 (Ct. App. 1982).

Negligence.

A depositor may be precluded by his own negligence from asserting lack of responsibility for losses to his account which result from forged checks, when the drawee bank pays the forged instruments in good faith and in accordance with reasonable commercial standards; such preclusive negligence can occur either before a check is honored by the bank, where the depositor substantially contributes to the making of an unauthorized signature, or after a check has been honored by the bank, where the depositor fails with reasonable care and promptness to examine his bank statements, discover an unauthorized signature, or report the discovery to the bank. Mercantile Stores Co. v. Idaho First Nat'l Bank, 102 Idaho 820, 641 P.2d 1007 (Ct. App. 1982).

In action against bank for payment of forged checks where evidence supported trial court's interpretation that the jury found that business was negligent and bank used ordinary care as provided in this section, except with regard to one check, business' negligence precluded it from asserting the unauthorized signatures as a defense on all the checks except for one check. Basterrechea Distrib., Inc. v. Idaho State Bank, 122 Idaho 572, 836 P.2d 518 (1992).

Ordinary Care.

In action against bank for payment of forged checks where no issue was raised on appeal by either party concerning instruction to jury that the term "reasonable commercial standards" as used in former section and "ordinary care" as used in this section were equivalent, evidence supported finding that, except for the one instance, ordinary care was used by bank. Basterrechea Distrib., Inc. v. Idaho State Bank, 122 Idaho 572, 836 P.2d 518 (1992).

RESEARCH REFERENCES

ALR. — Construction and application of UCC § 4-406, requiring customer to discover and report unauthorized signature, in cases involving bank's payment of check or withdrawal on less than required number of signatures. 7 A.L.R.4th 1111.

Official Comment

1. Under subsection (a), if a bank that has paid a check or other item for the account of a customer makes available to the customer a statement of account showing payment of the item, the bank must either return the item to the customer or provide a description of the item sufficient to allow the customer to identify it. Under subsection (c), the customer has a duty to exercise reasonable promptness in examining the statement or the returned item to discover any unauthorized signature of the customer or any alteration and to promptly notify the bank if the customer should reasonably have discovered the unauthorized signature or alteration.

The duty stated in subsection (c) becomes operative only if the "bank sends or makes available a statement of account or items pursuant to subsection (a)." A bank is not under a duty to send a statement of account or the paid items to the customer; but, if it does not do so, the customer does not have any duties under subsection (c).

Under subsection (a), a statement of account must provide information "sufficient to allow the customer reasonably to identify the items paid." If the bank supplies its customer with an image of the paid item, it complies with this standard. But a safe harbor rule is provided. The bank complies with the standard of providing "sufficient information" if "the item is described by item number, amount, and date of payment." This means that the customer's duties under subsection (c) are triggered if the bank sends a statement of account complying with the safe harbor rule without returning the paid items. A bank does not have to return the paid items unless it has agreed with the customer to do so. Whether there is such an agreement depends upon the particular circumstances. See Section 1-201(3). If the bank elects to provide the minimum information that is "sufficient" under subsection (a) and, as a consequence, the customer could not "reasonably have discovered the unauthorized payment," there is no preclusion under subsection (d). If the customer made a record of the issued checks on the check stub or carbonized copies furnished by the bank in the checkbook, the customer should usually be able to verify the paid items shown on the statement of account and discover any unauthorized or altered checks. But there could be exceptional circumstances. For example, if a check is altered by changing the name of the payee, the customer could not normally detect the fraud unless the customer is given the paid check or the statement of account discloses the name of the payee of the altered check. If the

customer could not “reasonably have discovered the unauthorized payment” under subsection (c) there would not be a preclusion under subsection (d).

The “safe harbor” provided by subsection (a) serves to permit a bank, based on the state of existing technology, to trigger the customer’s duties under subsection (c) by providing a “statement of account showing payment of items” without having to return the paid items, in any case in which the bank has not agreed with the customer to return the paid items. The “safe harbor” does not, however, preclude a customer under subsection (d) from asserting its unauthorized signature or an alteration against a bank in those circumstances in which under subsection (c) the customer should not “reasonably have discovered the unauthorized payment.” Whether the customer has failed to comply with its duties under subsection (c) is determined on a case-by-case basis.

The provision in subsection (a) that a statement of account contains “sufficient information if the item is described by item number, amount, and date of payment” is based upon the existing state of technology. This information was chosen because it can be obtained by the bank’s computer from the check’s MICR line without examination of the items involved. The other two items of information that the customer would normally want to know — the name of the payee and the date of the item — cannot currently be obtained from the MICR line. The safe harbor rule is important in determining the feasibility of payor or collecting bank check retention plans. A customer who keeps a record of checks written, e.g., on the check stubs or carbonized copies of the checks supplied by the bank in the checkbook, will usually have sufficient information to identify the items on the basis of item number, amount, and date of payment. But customers who do not utilize these record-keeping methods may not. The policy decision is that accommodating customers who do not keep adequate records is not as desirable as accommodating customers who keep more careful records. This policy results in less cost to the check collection system and thus to all customers of the system. It is expected that technological advances such as image processing may make it possible for banks to give customers more information in the future in a manner that is fully compatible with automation or truncation systems. At that time the Permanent Editorial Board may wish to make recommendations for an amendment revising the safe harbor requirements in the light of those advances.

2. Subsection (d) states the consequences of a failure by the customer to perform its duty under subsection (c) to report an alteration or the customer's unauthorized signature. Subsection (d)(1) applies to the unauthorized payment of the item to which the duty to report under subsection (c) applies. If the bank proves that the customer "should reasonably have discovered the unauthorized payment" (See Comment 1) and did not notify the bank, the customer is precluded from asserting against the bank the alteration or the customer's unauthorized signature if the bank proves that it suffered a loss as a result of the failure of the customer to perform its subsection (c) duty. Subsection (d)(2) applies to cases in which the customer fails to report an unauthorized signature or alteration with respect to an item in breach of the subsection (c) duty (See Comment 1) and the bank subsequently pays other items of the customer with respect to which there is an alteration or unauthorized signature of the customer and the same wrongdoer is involved. If the payment of the subsequent items occurred after the customer has had a reasonable time (not exceeding 30 days) to report with respect to the first item and before the bank received notice of the unauthorized signature or alteration of the first item, the customer is precluded from asserting the alteration or unauthorized signature with respect to the subsequent items.

If the customer is precluded in a single or multiple item unauthorized payment situation under subsection (d), but the customer proves that the bank failed to exercise ordinary care in paying the item or items and that the failure substantially contributed to the loss, subsection (e) provides a comparative negligence test for allocating loss between the customer and the bank. Subsection (e) also states that, if the customer proves that the bank did not pay the item in good faith, the preclusion under subsection (d) does not apply.

Subsection (d)(2) changes former subsection (2)(b) by adopting a 30-day period in place of a 14-day period. Although the 14-day period may have been sufficient when the original version of Article 4 was drafted in the 1950s, given the much greater volume of checks at the time of the revision, a longer period was viewed as more appropriate. The rule of subsection (d)(2) follows pre-Code case law that payment of an additional item or items bearing an unauthorized signature or alteration by the same wrongdoer is a loss suffered by the bank traceable to the customer's failure to exercise

reasonable care (See Comment 1) in examining the statement and notifying the bank of objections to it. One of the most serious consequences of failure of the customer to comply with the requirements of subsection (c) is the opportunity presented to the wrongdoer to repeat the misdeeds. Conversely, one of the best ways to keep down losses in this type of situation is for the customer to promptly examine the statement and notify the bank of an unauthorized signature or alteration so that the bank will be alerted to stop paying further items. Hence, the rule of subsection (d)(2) is prescribed, and to avoid dispute a specific time limit, 30 days, is designated for cases to which the subsection applies. These considerations are not present if there are no losses resulting from the payment of additional items. In these circumstances, a reasonable period for the customer to comply with its duties under subsection (c) would depend on the circumstances (Section 1-204 [1-205] (2)) and the subsection (d)(2) time limit should not be imported by analogy into subsection (c).

3. Subsection (b) applies if the items are not returned to the customer. Check retention plans may include a simple payor bank check retention plan or the kind of check retention plan that would be authorized by a truncation agreement in which a collecting bank or the payee may retain the items. Even after agreeing to a check retention plan, a customer may need to see one or more checks for litigation or other purposes. The customer's request for the check may always be made to the payor bank. Under subsection (b) retaining banks may destroy items but must maintain the capacity to furnish legible copies for seven years. A legible copy may include an image of an item. This Act does not define the length of the reasonable period of time for a bank to provide the check or copy of the check. What is reasonable depends on the capacity of the bank and the needs of the customer. This Act does not specify sanctions for failure to retain or furnish the items or legible copies; this is left to other laws regulating banks. See Comment 3 to Section 4-101. Moreover, this Act does not regulate fees that banks charge their customers for furnishing items or copies or other services covered by the Act, but under principles of law such as unconscionability or good faith and fair dealing, courts have reviewed fees and the bank's exercise of a discretion to set fees. *Perdue v. Crocker National Bank,* 38 Cal.3d 913 (1985) (unconscionability); *Best v. United Bank of Oregon,* 739 P.2d 554, 562-566 (1987) (good faith and fair dealing). In addition, Section 1-203 provides that every contract or duty

within this Act imposes an obligation of good faith in its performance or enforcement.

4. Subsection (e) replaces former subsection (3) and poses a modified comparative negligence test for determining liability. See the discussion on this point in the Comments to Sections 3-404, 3-405, and 3-406. The term "good faith" is defined in Section 3-103(a)(4) as including "observance of reasonable commercial standards of fair dealing." The connotation of this standard is fairness and not absence of negligence.

The term "ordinary care" used in subsection (e) is defined in Section 3-103(a)(7), made applicable to Article 4 by Section 4-104(c), to provide that sight examination by a payor bank is not required if its procedure is reasonable and is commonly followed by other comparable banks in the area. The case law is divided on this issue. The definition of "ordinary care" in Section 3-103 rejects those authorities that hold, in effect, that failure to use sight examination is negligence as a matter of law. The effect of the definition of "ordinary care" on Section 4-406 is only to provide that in the small percentage of cases in which a customer's failure to examine its statement or returned items has led to loss under subsection (d) a bank should not have to share that loss solely because it has adopted an automated collection or payment procedure in order to deal with the great volume of items at a lower cost to all customers.

5. Several changes are made in former Section 4-406(5). First, former subsection (5) is deleted and its substance is made applicable only to the one-year notice preclusion in former subsection (4)(subsection (f)). Thus if a drawer has not notified the payor bank of an unauthorized check or material alteration within the one-year period, the payor bank may not choose to recredit the drawer's account and pass the loss to the collecting banks on the theory of breach of warranty. Second, the reference in former subsection (4) to unauthorized indorsements is deleted. Section 4-406 imposes no duties on the drawer to look for unauthorized indorsements. Section 4-111 sets out a statute of limitations allowing a customer a three-year period to seek a credit to an account improperly charged by payment of an item bearing an unauthorized indorsement. Third, subsection (c) is added to Section 4-208 to assure that if a depositary bank is sued for breach of a presentment warranty, it can defend by showing that the drawer is precluded by Section 3-406 or Section 4-406 (c) and (d).

§ 28-4-407. Payor bank's right to subrogation on improper payment. — If a payor bank has paid an item over the order of the drawer or maker to stop payment, or after an account has been closed, or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank is subrogated to the rights

(a) of any holder in due course on the item against the drawer or maker;

(b) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(c) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

History.

1967, ch. 161, § 4-407, p. 351; am. 1993, ch. 288, § 41, p. 1019.

Official Comment

1. Section 4-403 states that a stop-payment order or an order to close an account is binding on a bank. If a bank pays an item over such an order it is prima facie liable, but under subsection (c) of Section 4-403 the burden of establishing the fact and amount of loss from such payment is on the customer. A defense frequently interposed by a bank in an action against it for wrongful payment over a stop-payment order is that the drawer or maker suffered no loss because it would have been liable to a holder in due course in any event. On this argument some cases have held that payment cannot be stopped against a holder in due course. Payment can be stopped, but if it is, the drawer or maker is liable and the sound rule is that the bank is subrogated to the rights of the holder in due course. The preamble and paragraph (1) of this section state this rule.

2. Paragraph (2) also subrogates the bank to the rights of the payee or other holder against the drawer or maker either on the item or under the

transaction out of which it arose. It may well be that the payee is not a holder in due course but still has good rights against the drawer. These may be on the check but also may not be as, for example, where the drawer buys goods from the payee and the goods are partially defective so that the payee is not entitled to the full price, but the goods are still worth a portion of the contract price. If the drawer retains the goods it is obligated to pay a part of the agreed price. If the bank has paid the check it should be subrogated to this claim of the payee against the drawer.

3. Paragraph (3) subrogates the bank to the rights of the drawer or maker against the payee or other holder with respect to the transaction out of which the item arose. If, for example, the payee was a fraudulent salesman inducing the drawer to issue a check for defective securities, and the bank pays the check over a stop-payment order but reimburses the drawer for such payment, the bank should have a basis for getting the money back from the fraudulent salesman.

4. The limitations of the preamble prevent the bank itself from getting any double recovery or benefits out of its subrogation rights conferred by the section.

5. The spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (Section 1-103). Among others these may include the defense of a payor bank that by conduct in recognizing the payment a customer has ratified the bank's action in paying in disregard of a stop-payment order or right to recover money paid under a mistake.

Part 5
Collection of Documentary Drafts

§ 28-4-501. Handling of documentary drafts — Duty to send for presentment and to notify customer of dishonor. — A bank that takes a documentary draft for collection shall present or send the draft and accompanying documents for presentment and, upon learning that the draft has not been paid or accepted in due course, shall seasonably notify its customer of the fact even though it may have discounted or brought the draft or extended credit available for withdrawal as of right.

History.

1967, ch. 161, § 4-501, p. 351; am. 1993, ch. 288, § 42, p. 1019.

Official Comment

This section states the duty of a bank handling a documentary draft for a customer. "Documentary draft" is defined in Section 4-104. The duty stated exists even if the bank has bought the draft. This is because to the customer the draft normally represents an underlying commercial transaction, and if that is not going through as planned the customer should know it promptly.

§ 28-4-502. Presentment of "on arrival" drafts. — If a draft or the relevant instructions require presentment "on arrival," "when goods arrive" or the like, the collecting bank need not present until in its judgment a reasonable time for arrival of the goods has expired. Refusal to pay or accept because the goods have not arrived is not dishonor; the bank must notify its transferor of the refusal but need not present the draft again until it is instructed to do so or learns of the arrival of the goods.

History.

1967, ch. 161, § 4-502, p. 351; am. 1993, ch. 288, § 43, p. 1019.

Official Comment

The section is designed to establish a definite rule for "on arrival" drafts. The term includes not only drafts drawn payable "on arrival" but also drafts forwarded with instructions to present "on arrival." The term refers to the arrival of the relevant goods. Unless a bank has actual knowledge of the arrival of the goods, as for example, when it is the "notify" party on the bill of lading, the section only requires the exercise of such judgment in estimating time as a bank may be expected to have. Commonly the buyer-drawee will want the goods and will therefore call for the documents and take up the draft when they do arrive.

§ 28-4-503. Responsibility of presenting bank for documents and goods — Report of reasons for dishonor — Referee in case of need. — Unless otherwise instructed and except as provided in chapter 5, a bank presenting a documentary draft:

(1) must deliver the documents to the drawee on acceptance of the draft if it is payable more than three (3) days after presentment; otherwise, only on payment; and

(2) upon dishonor, either in the case of presentment for acceptance or presentment for payment, may seek and follow instructions from any referee in case of need designated in the draft or, if the presenting bank does not choose to utilize the referee's services, it must use diligence and good faith to ascertain the reason for dishonor, must notify its transferor of the dishonor and of the results of its effort to ascertain the reasons therefor, and must request instructions.

However, the presenting bank is under no obligation with respect to goods represented by the documents except to follow any reasonable instructions seasonably received; it has a right to reimbursement for any expense incurred in the following instructions and to prepayment of or indemnity for those expenses.

History.

1967, ch. 161, § 4-503, p. 351; am. 1993, ch. 288, § 44, p. 1019.

Official Comment

1. This section states the rules governing, in the absence of instructions, the duty of the presenting bank in case either of honor or of dishonor of a documentary draft. The section should be read in connection with Section 2-514 on when documents are deliverable on acceptance, when on payment.

2. If the draft is drawn under a letter of credit, Article 5 controls. See Sections 5-109 through 5-114.

§ 28-4-504. Privilege of presenting bank to deal with goods — Security interest for expenses. — (1) A presenting bank that, following the dishonor of a documentary draft, has seasonably requested instructions but does not receive them within a reasonable time may store, sell, or otherwise deal with the goods in any reasonable manner.

(2) For its reasonable expenses incurred by action under subsection (1) of this section, the presenting bank has a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien.

History.

1967, ch. 161, § 4-504, p. 351; am. 1993, ch. 288, § 45, p. 1019.

Official Comment The section gives the presenting bank, after dishonor, a privilege to deal with the goods in any commercially reasonable manner pending instructions from its transferor and, if still unable to communicate with its principal after a reasonable time, a right to realize its expenditures as if foreclosing on an unpaid seller's lien (Section 2-706). The provision includes situations in which storage of goods or other action becomes commercially necessary pending receipt of any requested instructions, even if the requested instructions are later received.

The "reasonable manner" referred to means one reasonable in the light of business factors and the judgment of a business man.

Part 6
Funds Transfers Subject Matter and Definitions

STATUTORY NOTES

Compiler's notes. The numbering of the Idaho version of Article 4A, Funds Transfers of the Uniform Commercial Code differs from the numbering of the official version as approved by the National Conference of Commissioners on Uniform State Laws and the American Law Institute. The official version was numbered as §§ 4A-101 through 4A-507. The Idaho Funds Transfer Law enacted by S.L. 1991, ch. 135, § 1 is compiled as §§ 28-4-601 through 28-4-638, Idaho Code. In order to facilitate the use of the Official Comments, a parallel table has been provided showing the Idaho Code reference to the act in the column labeled "Idaho Code" with its parallel reference in the column labeled "Uniform Code".

28-4-601	4A-101
28-4-602	4A-102
28-4-603	4A-103
28-4-604	4A-104
28-4-605	4A-105
28-4-606	4A-106
28-4-607	4A-107
28-4-608	4A-108
28-4-609	4A-201
28-4-610	4A-202
28-4-611	4A-203
28-4-612	4A-204
28-4-613	4A-205
28-4-614	4A-206
28-4-615	4A-207
28-4-616	4A-208
28-4-617	4A-209

28-4-618	4A-210
28-4-619	4A-211
28-4-620	4A-212
28-4-621	4A-301
28-4-622	4A-302
28-4-623	4A-303
28-4-624	4A-304
28-4-625	4A-305
28-4-626	4A-401
28-4-627	4A-402
28-4-628	4A-403
28-4-629	4A-404
28-4-630	4A-405
28-4-631	4A-406
28-4-632	4A-501
28-4-633	4A-502
28-4-634	4A-503
28-4-635	4A-504
28-4-636	4A-505
28-4-637	4A-506
28-4-638	4A-507

§ 28-4-601. Short title. — This part may be cited as "Uniform Commercial Code — Funds Transfers."

History.

I.C., § 28-4-601, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-101 in the uniform act.

RESEARCH REFERENCES

ALR. — Construction and application to immediate parties of Uniform Commercial Code Article 4A governing funds transfers. 62 A.L.R.6th 1.

§ 28-4-602. Subject matter. — Except as otherwise provided in section 28-4-608[, Idaho Code], this part applies to funds transfers defined in section 28-4-604[, Idaho Code].

History.

I.C., § 28-4-602, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-102 in the uniform act.

The bracketed insertions in this section were added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

ALR. — Construction and application to immediate parties of Uniform Commercial Code Article 4A governing funds transfers. 62 A.L.R.6th 1.

Official Comment

Article 4A governs a specialized method of payment referred to in the Article as a funds transfer but also commonly referred to in the commercial community as a wholesale wire transfer. A funds transfer is made by means of one or more payment orders. The scope of Article 4A is determined by the definitions of "payment order" and "funds transfer" found in Section 4A-103 and Section 4A-104.

The funds transfer governed by Article 4A is in large part a product of recent and developing technological changes. Before this Article was drafted there was no comprehensive body of law — statutory or judicial — that defined the juridical nature of a funds transfer or the rights and obligations flowing from payment orders. Judicial authority with respect to funds transfers is sparse, undeveloped and not uniform. Judges have had to resolve disputes by referring to general principles of common law or equity,

or they have sought guidance in statutes such as Article 4 which are applicable to other payment methods. But attempts to define rights and obligations in funds transfers by general principles or by analogy to rights and obligations in negotiable instrument law or the law of check collection have not been satisfactory.

In the drafting of Article 4A, a deliberate decision was made to write on a clean slate and to treat a funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised by this method of payment. A deliberate decision was also made to use precise and detailed rules to assign responsibility, define behavioral norms, allocate risks and establish limits on liability, rather than to rely on broadly stated, flexible principles. In the drafting of these rules, a critical consideration was that the various parties to funds transfers need to be able to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately. This consideration is particularly important given the very large amounts of money that are involved in funds transfers.

Funds transfers involve competing interests — those of the banks that provide funds transfer services and the commercial and financial organizations that use the services, as well as the public interest. These competing interests were represented in the drafting process and they were thoroughly considered. The rules that emerged represent a careful and delicate balancing of those interests and are intended to be the exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article. Consequently, resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article.

§ 28-4-603. Payment order — Definitions. — (1) In this part:

(a) "Beneficiary" means the person to be paid by the beneficiary's bank.

(b) "Beneficiary's bank" means the bank identified in a payment order in which an account of the beneficiary is to be credited pursuant to the order or which otherwise is to make payment to the beneficiary if the order does not provide for payment to an account.

(c) "Payment order" means an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if: (i) the instruction does not state a condition to payment to the beneficiary other than time of payment, (ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and (iii) the instruction is transmitted by the sender directly to the receiving bank or to an agent, funds-transfer system, or communication system for transmittal to the receiving bank.

(d) "Receiving bank" means the bank to which the sender's instruction is addressed.

(e) "Sender" means the person giving the instruction to the receiving bank.

(2) If an instruction complying with subsection (1)(a) is to make more than one (1) payment to a beneficiary, the instruction is a separate payment order with respect to each payment.

(3) A payment order is issued when it is sent to the receiving bank.

History.

I.C., § 28-4-603, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-103 in the uniform act.

Official Comment

This section is discussed in the Comment following Section 4A-104.

§ 28-4-604. Funds transfer — Definitions. — In this part:

(1) "Funds transfer" means the series of transactions, beginning with the originator's payment order, made for the purpose of making payment to the beneficiary of the order. The term includes any payment order issued by the originator's bank or an intermediary bank intended to carry out the originator's payment order. A funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary of the originator's payment order.

(2) "Intermediary bank" means a receiving bank other than the originator's bank or the beneficiary's bank.

(3) "Originator" means the sender of the first payment order in a funds transfer.

(4) "Originator's bank" means:

(a) the receiving bank to which the payment order of the originator is issued if the originator is not a bank, or

(b) the originator if the originator is a bank.

History.

I.C., § 28-4-604, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-104 in the uniform act.

Official Comment

1. Article 4A governs a method of payment in which the person making payment (the "originator") directly transmits an instruction to a bank either to make payment to the person receiving payment (the "beneficiary") or to instruct some other bank to make payment to the beneficiary. The payment from the originator to the beneficiary occurs when the bank that is to pay

the beneficiary becomes obligated to pay the beneficiary. There are two basic definitions: "Payment order" stated in Section 4A-103 and "Funds transfer" stated in Section 4A-104. These definitions, other related definitions, and the scope of Article 4A can best be understood in the context of specific fact situations. Consider the following cases:

Case #1. X, which has an account in Bank A, instructs that bank to pay $1,000,000 to Y's account in Bank A. Bank A carries out X's instruction by making a credit of $1,000,000 to Y's account and notifying Y that the credit is available for immediate withdrawal. The instruction by X to Bank A is a "payment order" which was issued when it was sent to Bank A. Section 4A-103(a)(1) and (c). X is the "sender" of the payment order and Bank A is the "receiving bank." Section 4A-103(a)(5) and (a)(4). Y is the "beneficiary" of the payment order and Bank A is the "beneficiary's bank." Section 4A-103(a)(2) and (a)(3). When Bank A notified Y of receipt of the payment order, Bank A "accepted" the payment order. Section 4A-209(b)(1). When Bank A accepted the order it incurred an obligation to Y to pay the amount of the order. Section 4A-404(a). When Bank A accepted X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(b). Payment from X to Bank A would normally be made by a debit to X's account in Bank A. Section 4A-403(a)(3). At the time Bank A incurred the obligation to pay Y, payment of $1,000,000 by X to Y was also made. Section 4A-406(a). Bank A paid Y when it gave notice to Y of a withdrawable credit of $1,000,000 to Y's account. Section 4A-405(a). The overall transaction, which comprises the acts of X and Bank A, in which the payment by X to Y is accomplished is referred to as the "funds transfer." Section 4A-104(a). In this case only one payment order was involved in the funds transfer. A one-payment-order funds transfer is usually referred to as a "book transfer" because the payment is accomplished by the receiving bank's debiting the account of the sender and crediting the account of the beneficiary in the same bank. X, in addition to being the sender of the payment order to Bank A, is the "originator" of the funds transfer. Section 4A-104(c). Bank A is the "originator's bank" in the funds transfer as well as the beneficiary's bank. Section 4A-104(d).

Case #2. Assume the same facts as in Case #1 except that X instructs Bank A to pay $1,000,000 to Y's account in Bank B. With respect to this payment order, X is the sender, Y is the beneficiary, and Bank A is the receiving bank. Bank A carries out X's order by instructing Bank B to pay $1,000,000 to Y's account. This instruction is a payment order in which Bank A is the sender, Bank B is the receiving bank, and Y is the beneficiary. When Bank A issued its payment order to Bank B, Bank A "executed" X's order. Section 4A-301(a). In the funds transfer, X is the originator, Bank A is the originator's bank, and Bank B is the beneficiary's bank. When Bank A executed X's order, X incurred an obligation to pay Bank A the amount of the order. Section 4A-402(c). When Bank B accepts the payment order issued to it by Bank A, Bank B incurs an obligation to Y to pay the amount of the order (Section 4A-404(a)) and Bank A incurs an obligation to pay Bank B. Section 4A-402(b). Acceptance by Bank B also results in payment of $1,000,000 by X to Y. Section 4A-406(a). In this case two payment orders are involved in the funds transfer.

Case #3. Assume the same facts as in Case #2 except that Bank A does not execute X's payment order by issuing a payment order to Bank B. One bank will not normally act to carry out a funds transfer for another bank unless there is a preexisting arrangement between the banks for transmittal of payment orders and settlement of accounts. For example, if Bank B is a foreign bank with which Bank A has no relationship, Bank A can utilize a bank that is a correspondent of both Bank A and Bank B. Assume Bank A issues a payment order to Bank C to pay $1,000,000 to Y's account in Bank B. With respect to this order, Bank A is the sender, Bank C is the receiving bank, and Y is the beneficiary. Bank C will execute the payment order of Bank A by issuing a payment order to Bank B to pay $1,000,000 to Y's account in Bank B. With respect to Bank C's payment order, Bank C is the sender, Bank B is the receiving bank, and Y is the beneficiary. Payment of $1,000,000 by X to Y occurs when Bank B accepts the payment order issued to it by Bank C. In this case the funds transfer involves three payment orders. In the funds transfer, X is the originator, Bank A is the originator's bank, Bank B is the beneficiary's bank, and Bank C is an "intermediary bank." Section 4A-104(b). In

some cases there may be more than one intermediary bank, and in those cases each intermediary bank is treated like Bank C in Case #3.

As the three cases demonstrate, a payment under Article 4A involves an overall transaction, the funds transfer, in which the originator, X, is making payment to the beneficiary, Y, but the funds transfer may encompass a series of payment orders that are issued in order to effect the payment initiated by the originator's payment order.

In some cases the originator and the beneficiary may be the same person. This will occur, for example, when a corporation orders a bank to transfer funds from an account of the corporation in that bank to another account of the corporation in that bank or in some other bank. In some funds transfers the first bank to issue a payment order is a bank that is executing a payment order of a customer that is not a bank. In this case the customer is the originator. In other cases, the first bank to issue a payment order is not acting for a customer, but is making a payment for its own account. In that event the first bank to issue a payment order is the originator as well as the originator's bank.

2. "Payment order" is defined in Section 4A-103(a)(1) as an instruction to a bank to pay, or to cause another bank to pay, a fixed or determinable amount of money. The bank to which the instruction is addressed is known as the "receiving bank." Section 4A-103(a)(4). "Bank" is defined in Section 4A-105(a)(2). The effect of this definition is to limit Article 4A to payments made through the banking system. A transfer of funds made by an entity outside the banking system is excluded. A transfer of funds through an entity other than a bank is usually a consumer transaction involving relatively small amounts of money and a single contract carried out by transfers of cash or a cash equivalent such as a check. Typically, the transferor delivers cash or a check to the company making the transfer, which agrees to pay a like amount to a person designated by the transferor. Transactions covered by Article 4A typically involve very large amounts of money in which several transactions involving several banks may be necessary to carry out the payment. Payments are normally made by debits or credits to bank accounts. Originators and beneficiaries are almost always business organizations and the transfers are usually made to pay obligations. Moreover, these transactions are frequently done on the basis of very short-term credit granted by the receiving bank to the sender of the

payment order. Wholesale wire transfers involve policy questions that are distinct from those involved in consumer-based transactions by nonbanks.

3. Further limitations on the scope of Article 4A are found in the three requirements found in subparagraphs (i), (ii), and (iii) of Section 4A-103(a)(1). Subparagraph (i) states that the instruction to pay is a payment order only if it "does not state a condition to payment to the beneficiary other than time of payment." An instruction to pay a beneficiary sometimes is subject to a requirement that the beneficiary perform some act such as delivery of documents. For example, a New York bank may have issued a letter of credit in favor of X, a California seller of goods to be shipped to the New York bank's customer in New York. The terms of the letter of credit provide for payment to X if documents are presented to prove shipment of the goods. Instead of providing for presentment of the documents to the New York bank, the letter of credit states that they may be presented to a California bank that acts as an agent for payment. The New York bank sends an instruction to the California bank to pay X upon presentation of the required documents. The instruction is not covered by Article 4A because payment to the beneficiary is conditional upon receipt of shipping documents. The function of banks in a funds transfer under Article 4A is comparable to the role of banks in the collection and payment of checks in that it is essentially mechanical in nature. The low price and high speed that characterize funds transfers reflect this fact. Conditions to payment by the California bank other than time of payment impose responsibilities on that bank that go beyond those in Article 4A funds transfers. Although the payment by the New York bank to X under the letter of credit is not covered by Article 4A, if X is paid by the California bank, payment of the obligation of the New York bank to reimburse the California bank could be made by an Article 4A funds transfer. In such a case there is a distinction between the payment by the New York bank to X under the letter of credit and the payment by the New York bank to the California bank. For example, if the New York bank pays its reimbursement obligation to the California bank by a Fedwire naming the California bank as beneficiary (see Comment 1 to Section 4A-107, payment is made to the California bank rather than to X. That payment is governed by Article 4A and it could be made either before or after payment by the California bank to X. The payment by the New York bank to X under the letter of credit is not governed by Article 4A and it occurs when the California bank, as agent of the New York bank, pays X.

No payment order was involved in that transaction. In this example, if the New York bank had erroneously sent an instruction to the California bank unconditionally instructing payment to X, the instruction would have been an Article 4A payment order. If the payment order was accepted (Section 4A-209(b)) by the California bank, a payment by the New York bank to X would have resulted (Section 4A-406(a)). But Article 4A would not prevent recovery of funds from X on the basis that X was not entitled to retain the funds under the law of mistake and restitution, letter of credit law or other applicable law.

4. Transfers of funds made through the banking system are commonly referred to as either "credit" transfers or "debit" transfers. In a credit transfer the instruction to pay is given by the person making payment. In a debit transfer the instruction to pay is given by the person receiving payment. The purpose of subparagraph (ii) of subsection (a)(1) of Section 4A-103 is to include credit transfers in Article 4A and to exclude debit transfers. All of the instructions to pay in the three cases described in Comment 1 fall within subparagraph (ii). Take Case #2 as an example. With respect to X's instruction given to Bank A, Bank A will be reimbursed by debiting X's account or otherwise receiving payment from X. With respect to Bank A's instruction to Bank B, Bank B will be reimbursed by receiving payment from Bank A. In a debit transfer, a creditor, pursuant to authority from the debtor, is enabled to draw on the debtor's bank account by issuing an instruction to pay to the debtor's bank. If the debtor's bank pays, it will be reimbursed by the debtor rather than by the person giving the instruction. For example, the holder of an insurance policy may pay premiums by authorizing the insurance company to order the policyholder's bank to pay the insurance company. The order to pay may be in the form of a draft covered by Article 3, or it might be an instruction to pay that is not an instrument under that Article. The bank receives reimbursement by debiting the policyholder's account. Or, a subsidiary corporation may make payments to its parent by authorizing the parent to order the subsidiary's bank to pay the parent from the subsidiary's account. These transactions are not covered by Article 4A because subparagraph (2) is not satisfied. Article 4A is limited to transactions in which the account to be debited by the receiving bank is that of the person in whose name the instruction is given.

If the beneficiary of a funds transfer is the originator of the transfer, the transfer is governed by Article 4A if it is a credit transfer in form. If it is in the form of a debit transfer it is not governed by Article 4A. For example, Corporation has accounts in Bank A and Bank B. Corporation instructs Bank A to pay to Corporation's account in Bank B. The funds transfer is governed by Article 4A. Sometimes, Corporation will authorize Bank B to draw on Corporation's account in Bank A for the purpose of transferring funds into Corporation's account in Bank B. If Corporation also makes an agreement with Bank A under which Bank A is authorized to follow instructions of Bank B, as agent of Corporation, to transfer funds from Customer's account in Bank A, the instruction of Bank B is a payment order of Customer and is governed by Article 4A. This kind of transaction is known in the wire-transfer business as a "drawdown transfer." If Corporation does not make such an agreement with Bank A and Bank B instructs Bank A to make the transfer, the order is in form a debit transfer and is not governed by Article 4A. These debit transfers are normally ACH transactions in which Bank A relies on Bank B's warranties pursuant to ACH rules, including the warranty that the transfer is authorized.

5. The principal effect of subparagraph (iii) of subsection (a) of Section 4A-103 is to exclude from Article 4A payments made by check or credit card. In those cases the instruction of the debtor to the bank on which the check is drawn or to which the credit-card slip is to be presented is contained in the check or credit-card slip signed by the debtor. The instruction is not transmitted by the debtor directly to the debtor's bank. Rather, the instruction is delivered or otherwise transmitted by the debtor to the creditor who then presents it to the bank either directly or through bank collection channels. These payments are governed by Articles 3 and 4 and federal law. There are, however, limited instances in which the paper on which a check is printed can be used as the means of transmitting a payment order that is covered by Article 4A. Assume that Originator instructs Originator's Bank to pay $10,000 to the account of Beneficiary in Beneficiary's Bank. Since the amount of Originator's payment order is small, if Originator's Bank and Beneficiary's Bank do not have an account relationship, Originator's Bank may execute Originator's order by issuing a teller's check payable to Beneficiary's Bank for $10,000 along with instructions to credit Beneficiary's account in that amount. The instruction to Beneficiary's Bank to credit Beneficiary's account is a payment order.

The check is the means by which Originator's Bank pays its obligation as sender of the payment order. The instruction of Originator's Bank to Beneficiary's Bank might be given in a letter accompanying the check or it may be written on the check itself. In either case the instruction to Beneficiary's Bank is a payment order but the check itself (which is an order to pay addressed to the drawee rather than to Beneficiary's Bank) is an instrument under Article 3 and is not a payment order. The check can be both the means by which Originator's Bank pays its obligation under § 4A-402(b) to Beneficiary's Bank and the means by which the instruction to Beneficiary's Bank is transmitted.

6. Most payments covered by Article 4A are commonly referred to as wire transfers and usually involve some kind of electronic transmission, but the applicability of Article 4A does not depend upon the means used to transmit the instruction of the sender. Transmission may be by letter or other written communication, oral communication or electronic communication. An oral communication is normally given by telephone. Frequently the message is recorded by the receiving bank to provide evidence of the transaction, but apart from problems of proof there is no need to record the oral instruction. Transmission of an instruction may be a direct communication between the sender and the receiving bank or through an intermediary such as an agent of the sender, a communication system such as international cable, or a funds transfer system such as CHIPS, SWIFT or an automated clearing house.

§ 28-4-605. Other definitions. — (1) In this part:

(a) "Authorized account" means a deposit account of a customer in a bank designated by the customer as a source of payment of payment orders issued by the customer to the bank. If a customer does not so designate an account, any account of the customer is an authorized account if payment of a payment order from that account is not inconsistent with a restriction on the use of that account.

(b) "Bank" means a person engaged in the business of banking and includes a savings bank, savings and loan association, credit union, and trust company. A branch or separate office of a bank is a separate bank for purposes of this part.

(c) "Customer" means a person, including a bank, having an account with a bank or from whom a bank has agreed to receive payment orders.

(d) "Funds-transfer business day" of a receiving bank means the part of a day during which the receiving bank is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders.

(e) "Funds-transfer system" means a wire transfer network, automated clearing house, or other communication system of a clearing house or other association of banks through which a payment order by a bank may be transmitted to the bank to which the order is addressed.

(f) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(g) "Prove" with respect to a fact means to meet the burden of establishing the fact (section 28-1-201(b)(8)[, Idaho Code]).

(2) Other definitions applying to this part and the sections in which they appear are: "Acceptance" Section 28-4-617[, Idaho Code]

"Beneficiary" Section 28-4-603[, Idaho Code]

"Beneficiary's bank" Section 28-4-603[, Idaho Code]

"Executed" Section 28-4-621[, Idaho Code]

"Execution date" Section 28-4-621[, Idaho Code]

"Funds transfer" Section 28-4-604[, Idaho Code]

"Funds-transfer system rule" Section 28-4-632[, Idaho Code]

"Intermediary bank" Section 28-4-604[, Idaho Code]

"Originator" Section 28-4-604[, Idaho Code]

"Originator's bank" Section 28-4-604[, Idaho Code]

"Payment by beneficiary's bank to beneficiary" Section 28-4-630[, Idaho Code]

"Payment by originator to beneficiary" Section 28-4-631[, Idaho Code]

"Payment by sender to receiving bank" Section 28-4-628[, Idaho Code]

"Payment date" Section 28-4-626[, Idaho Code]

"Payment order" Section 28-4-603[, Idaho Code]

"Receiving bank" Section 28-4-603[, Idaho Code]

"Security procedure" Section 28-4-609[, Idaho Code]

"Sender" Section 28-4-603[, Idaho Code]

(3) The following definitions in article 4[, chapter 4, title 28, Idaho Code,] apply to this part: "Clearing house" Section 28-4-104[, Idaho Code]

"Item" Section 28-4-104[, Idaho Code]

"Suspends payments" Section 28-4-104[, Idaho Code]

(4) In addition article 1[, chapter 1, title 28, Idaho Code,] contains general definitions and principles of construction and interpretation applicable throughout this part.

History.

I.C., § 28-4-605, as added by 1991, ch. 135, § 1, p. 295; am. 2004, ch. 43, § 32, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-105 in the uniform act.

The bracketed insertions throughout this section were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

Official Comment

1. The definition of "bank" in subsection (a)(2) includes some institutions that are not commercial banks. The definition reflects the fact that many financial institutions now perform functions previously restricted to commercial banks, including acting on behalf of customers in funds transfers. Since many funds transfers involve payment orders to or from foreign countries the definition also covers foreign banks. The definition also includes Federal Reserve Banks. Funds transfers carried out by Federal Reserve Banks are described in Comments 1 and 2 to Section 4A-107.

2. Funds transfer business is frequently transacted by banks outside of general banking hours. Thus, the definition of banking day in Section 4-104(1)(c) cannot be used to describe when a bank is open for funds transfer business. Subsection (a)(4) defines a new term, "funds transfer business day," which is applicable to Article 4A. The definition states, "is open for the receipt, processing, and transmittal of payment orders and cancellations and amendments of payment orders." In some cases it is possible to electronically transmit payment orders and other communications to a receiving bank at any time. If the receiving bank is not open for the processing of an order when it is received, the communication is stored in the receiving bank's computer for retrieval when the receiving bank is open for processing. The use of the conjunctive makes clear that the defined term is limited to the period during which all functions of the receiving bank can be performed, i.e., receipt, processing, and transmittal of payment orders, cancellations and amendments.

3. Subsection (a)(5) defines "funds transfer system." The term includes a system such as CHIPS which provides for transmission of a payment order as well as settlement of the obligation of the sender to pay the order. It also includes automated clearing houses, operated by a clearing house or other association of banks, which process and transmit payment orders of banks to other banks. In addition the term includes organizations that provide only

transmission services such as SWIFT. The definition also includes the wire transfer network and automated clearing houses of Federal Reserve Banks. Systems of the Federal Reserve Banks, however, are treated differently from systems of other associations of banks. Funds transfer systems other than systems of the Federal Reserve Banks are treated in Article 4A as a means of communication of payment orders between participating banks. Section 4A-206. The Comment to that section and the Comment to Section 4A-107 explain how Federal Reserve Banks function under Article 4A. Funds transfer systems are also able to promulgate rules binding on participating banks that, under Section 4A-501, may supplement or in some cases may even override provisions of Article 4A.

4. Subsection (d) incorporates definitions stated in Article 1 as well as principles of construction and interpretation stated in that Article. Included is Section 1-103. The last paragraph of the Comment to Section 4A-102 is addressed to the issue of the extent to which general principles of law and equity should apply to situations covered by provisions of Article 4A.

§ 28-4-606. Time payment order is received. — (1) The time of receipt of a payment order or communication canceling or amending a payment order is determined by the rules applicable to receipt of a notice stated in section 28-1-202[, Idaho Code]. A receiving bank may fix a cut-off time or times on a funds-transfer business day for the receipt and processing of payment orders and communications canceling or amending payment orders. Different cut-off times may apply to payment orders, cancellations, or amendments, or to different categories of payment orders, cancellations, or amendments. A cut-off time may apply to senders generally or different cut-off times may apply to different senders or categories of payment orders. If a payment order or communication canceling or amending a payment order is received after the close of a funds-transfer business day or after the appropriate cut-off time on a funds-transfer business day, the receiving bank may treat the payment order or communication as received at the opening of the next funds-transfer business day.

(2) If this part refers to an execution date or payment date or states a day on which a receiving bank is required to take action, and the date or day does not fall on a funds-transfer business day, the next day that is a funds-transfer business day is treated as the date or day stated, unless the contrary is stated in this part.

History.

I.C., § 28-4-606, as added by 1991, ch. 135, § 1, p. 295; am. 2004, ch. 43, § 33, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-106 in the uniform act.

The bracketed insertion in subsection (1) was added by the compiler to conform to the statutory citation style.

Official Comment The time that a payment order is received by a receiving bank usually defines the payment date or the execution date of a payment order. Section 4A-401 and Section 4A-301. The time of receipt of a payment order, or communication cancelling or amending a payment order is defined in subsection (a) by reference to the rules stated in Section 1-202. Thus, time of receipt is determined by the same rules that determine when a notice is received. Time of receipt, however, may be altered by a cut-off time.

§ 28-4-607. Federal reserve regulations and operating circulars. — Regulations of the board of governors of the Federal Reserve System and operating circulars of the Federal Reserve banks supersede any inconsistent provision of this part to the extent of the inconsistency.

History.

I.C., § 28-4-607, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-107 in the uniform act.

Official Comment

1. Funds transfers under Article 4A may be made, in whole or in part, by payment orders through a Federal Reserve Bank in what is usually referred to as a transfer by Fedwire. If Bank A, which has an account in Federal Reserve Bank X, wants to pay $1,000,000 to Bank B, which has an account in Federal Reserve Bank Y, Bank A can issue an instruction to Reserve Bank X requesting a debit of $1,000,000 to Bank A's Reserve account and an equal credit to Bank B's Reserve account. Reserve Bank X will debit Bank A's account and will credit the account of Reserve Bank Y. Reserve Bank X will issue an instruction to Reserve Bank Y requesting a debit of $1,000,000 to the account of Reserve Bank X and an equal credit to Bank B's account in Reserve Bank Y. Reserve Bank Y will make the requested debit and credit and will give Bank B an advice of credit. The definition of "bank" in Section 4A-105(a)(2) includes both Reserve Bank X and Reserve Bank Y. Bank A's instruction to Reserve Bank X to pay money to Bank B is a payment order under Section 4A-103(a)(1). Bank A is the sender and Reserve Bank X is the receiving bank. Bank B is the beneficiary of Bank A's order and of the funds transfer. Bank A is the originator of the funds transfer and is also the originator's bank. Section 4A-104(c) and (d). Reserve Bank X, an intermediary bank under Section 4A-104(b), executes Bank A's order by sending a payment order to Reserve Bank Y instructing

that bank to credit the Federal Reserve account of Bank B. Reserve Bank Y is the beneficiary's bank.

Suppose the transfer of funds from Bank A to Bank B is part of a larger transaction in which Originator, a customer of Bank A, wants to pay Beneficiary, a customer of Bank B. Originator issues a payment order to Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A may execute Originator's order by means of Fedwire which simultaneously transfers $1,000,000 from Bank A to Bank B and carries a message instructing Bank B to pay $1,000,000 to the account of Y. The Fedwire transfer is carried out as described in the previous paragraph, except that the beneficiary of the funds transfer is Beneficiary rather than Bank B. Reserve Bank X and Reserve Bank Y are intermediary banks. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account it will also instruct Bank B to pay to the account of Beneficiary. The instruction is a payment order to Bank B which is the beneficiary's bank. When Reserve Bank Y advises Bank B of the credit to its Federal Reserve account Bank B receives payment of the payment order issued to it by Reserve Bank Y. Section 4A-403(a)(1). The payment order is automatically accepted by Bank B at the time it receives the payment order of Reserve Bank Y. Section 4A-209(b)(2). At the time of acceptance by Bank B payment by Originator to Beneficiary also occurs. Thus, in a Fedwire transfer, payment to the beneficiary's bank, acceptance by the beneficiary's bank and payment by the originator to the beneficiary all occur simultaneously by operation of law at the time the payment order to the beneficiary's bank is received.

If Originator orders payment to the account of Beneficiary in Bank C rather than Bank B, the analysis is somewhat modified. Bank A may not have any relationship with Bank C and may not be able to make payment directly to Bank C. In that case, Bank A could send a Fedwire instructing Bank B to instruct Bank C to pay Beneficiary. The analysis is the same as the previous case except that Bank B is an intermediary bank and Bank C is the beneficiary's bank.

2. A funds transfer can also be made through a Federal Reserve Bank in an automated clearing house transaction. In a typical case, Originator instructs Originator's Bank to pay to the account of Beneficiary in Beneficiary's Bank. Originator's instruction to pay a particular beneficiary is transmitted to Originator's Bank along with many other instructions for

payment to other beneficiaries by many different beneficiary's banks. All of these instructions are contained in a magnetic tape or other electronic device. Transmission of instructions to the various beneficiary's banks requires that Originator's instructions be processed and repackaged with instructions of other originators so that all instructions to a particular beneficiary's bank are transmitted together to that bank. The repackaging is done in processing centers usually referred to as automated clearing houses. Automated clearing houses are operated either by Federal Reserve Banks or by other associations of banks. If Originator's Bank chooses to execute Originator's instructions by transmitting them to a Federal Reserve Bank for processing by the Federal Reserve Bank, the transmission to the Federal Reserve Bank results in the issuance of payment orders by Originator's Bank to the Federal Reserve Bank, which is an intermediary bank. Processing by the Federal Reserve Bank will result in the issuance of payment orders by the Federal Reserve Bank to Beneficiary's Bank as well as payment orders to other beneficiary's banks making payments to carry out Originator's instructions.

3. Although the terms of Article 4A apply to funds transfers involving Federal Reserve Banks, federal preemption would make ineffective any Article 4A provision that conflicts with federal law. The payments activities of the Federal Reserve Banks are governed by regulations of the Federal Reserve Board and by operating circulars issued by the Reserve Banks themselves. In some instances, the operating circulars are issued pursuant to a Federal Reserve Board regulation. In other cases, the Reserve Bank issues the operating circular under its own authority under the Federal Reserve Act, subject to review by the Federal Reserve Board. Section 4A-107 states that Federal Reserve Board regulations and operating circulars of the Federal Reserve Banks supersede any inconsistent provision of Article 4A to the extent of the inconsistency. Federal Reserve Board regulations, being valid exercises of regulatory authority pursuant to a federal statute, take precedence over state law if there is an inconsistency. *Childs v. Federal Reserve Bank of Dallas*, 719 F.2d 812 (5th Cir. 1983), reh. den. 724 F.2d 127 (5th Cir. 1984). Section 4A-107 treats operating circulars as having the same effect whether issued under the Reserve Bank's own authority or under a Federal Reserve Board regulation.

§ 28-4-608. Relationship to electronic fund transfer act. — (1) Except as provided in subsection (2) of this section, this part does not apply to a funds transfer any part of which is governed by the electronic fund transfer act of 1978 (title XX, public law 95-630, 92 stat. 3728, 15 U.S.C. section 1693 et seq.) as amended from time to time.

(2) This part applies to a funds transfer that is a remittance transfer as defined in the electronic fund transfer act (15 U.S.C. section 1693o-1) as amended from time to time, unless the remittance transfer is an electronic fund transfer as defined in the electronic fund transfer act (15 U.S.C. section 1693a) as amended from time to time.

(3) In a funds transfer to which this part applies, in the event of an inconsistency between an applicable provision of this part and an applicable provision of the electronic fund transfer act, the provision of the electronic fund transfer act governs to the extent of the inconsistency.

History.

I.C., § 28-4-608, as added by 1991, ch. 135, § 1, p. 295; am. 2013, ch. 73, § 1, p. 188.

STATUTORY NOTES

Amendments.

The 2013 amendment, by ch. 73, substituted the current section heading for the former which read: "Exclusion of consumer transactions governed by federal law" and added subsections (2) and (3).

Compiler's Notes.

This section is designated as section 4A-108 in the uniform act.

The words enclosed in parentheses so appeared in the law as enacted.

RESEARCH REFERENCES

ALR. — Validity, construction, and application of Electronic Fund Transfer Act (EFTA), and regulations promulgated thereunder, 15 USCS §§

1693 et seq. 46 A.L.R. Fed. 2d 473.

Official Comment

The Electronic Fund Transfer Act of 1978 is a federal statute that covers a wide variety of electronic funds transfers involving consumers. The types of transfers covered by the federal statute are essentially different from the wholesale wire transfers that are the primary focus of Article 4A. Section 4A-108 excludes a funds transfer from Article 4A if any part of the transfer is covered by the federal law. Existing procedures designed to comply with federal law will not be affected by Article 4A. The effect of Section 4A-108 is to make Article 4A and EFTA mutually exclusive. For example, if a funds transfer is to a consumer account in the beneficiary's bank and the funds transfer is made in part by use of Fedwire and in part by means of an automated clearing house, EFTA applies to the ACH part of the transfer but not to the Fedwire part. Under Section 4A-108, Article 4A does not apply to any part of the transfer. However, in the absence of any law to govern the part of the funds transfer that is not subject to EFTA, a court might apply appropriate principles from Article 4A by analogy.

ISSUE AND ACCEPTANCE OF PAYMENT ORDER

Idaho Code § 28-4-609

§ 28-4-609. Security procedure. — "Security procedure" means a procedure established by agreement of a customer and a receiving bank for the purpose of (1) verifying that a payment order or communication amending or cancelling a payment order is that of the customer, or (2) detecting error in the transmission or the content of the payment order or communication. A security procedure may require the use of algorithms or other codes, identifying words or numbers, encryption, callback procedures, or similar security devices. Comparison of a signature on a payment order or communication with an authorized specimen signature of the customer is not by itself a security procedure.

History.

I.C., § 28-4-609, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-201 in the uniform act.

Official Comment A large percentage of payment orders and communications amending or cancelling payment orders are transmitted electronically and it is standard practice to use security procedures that are designed to assure the authenticity of the message. Security procedures can also be used to detect error in the content of messages or to detect payment orders that are transmitted by mistake as in the case of multiple transmission of the same payment order. Security procedures might also apply to communications that are transmitted by telephone or in writing. Section 4A-201 defines these security procedures. The definition of security procedure limits the term to a procedure "established by agreement of a customer and a receiving bank." The term does not apply to procedures that the receiving bank may follow unilaterally in processing payment orders.

The question of whether loss that may result from the transmission of a spurious or erroneous payment order will be borne by the receiving bank or the sender or purported sender is affected by whether a security procedure was or was not in effect and whether there was or was not compliance with the procedure. Security procedures are referred to in Sections 4A-202 and 4A-203, which deal with authorized and verified payment orders, and Section 4A-205, which deals with erroneous payment orders.

§ 28-4-610. Authorized and verified payment orders. — (1) A payment order received by the receiving bank is the authorized order of the person identified as sender if that person authorized the order or is otherwise bound by it under the law of agency.

(2) If a bank and its customer have agreed that the authenticity of payment orders issued to the bank in the name of the customer as sender will be verified pursuant to a security procedure, a payment order received by the receiving bank is effective as the order of the customer, whether or not authorized, if:

(a) the security procedure is a commercially reasonable method of providing security against unauthorized payment orders, and

(b) the bank proves that it accepted the payment order in good faith and in compliance with the security procedure and any written agreement or instruction of the customer restricting acceptance of payment orders issued in the name of the customer.

The bank is not required to follow an instruction that violates a written agreement with the customer or notice of which is not received at a time and in a manner affording the bank a reasonable opportunity to act on it before the payment order is accepted.

(3) Commercial reasonableness of a security procedure is a question of law to be determined by considering the wishes of the customer expressed to the bank, the circumstances of the customer known to the bank, including the size, type, and frequency of payment orders normally issued by the customer to the bank, alternative security procedures offered to the customer, and security procedures in general use by customers and receiving banks similarly situated. A security procedure is deemed to be commercially reasonable if:

(a) the security procedure was chosen by the customer after the bank offered, and the customer refused, a security procedure that was commercially reasonable for that customer, and

(b) the customer expressly agreed in writing to be bound by any payment order, whether or not authorized, issued in its name and accepted by the

bank in compliance with the security procedure chosen by the customer.

(4) The term “sender” in this part includes the customer in whose name a payment order is issued if the order is the authorized order of the customer under subsection (1) of this section, or it is effective as the order of the customer under subsection (2) of this section.

(5) This section applies to amendments and cancellations of payment orders to the same extent it applies to payment orders.

(6) Except as provided in this section and in section 28-4-611(1)(a)[, Idaho Code], rights and obligations arising under this section or section 28-4-611[, Idaho Code,] may not be varied by agreement.

History.

I.C., § 28-4-610, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler’s Notes.

This section is designated as section 4A-202 in the uniform act.

The bracketed insertions in subsection (6) were added by the compiler to conform to the statutory citation style.

Official Comment

This section is discussed in the Comment following Section 4A-203.

§ 28-4-611. Unenforceability of certain verified payment orders. — (1) If an accepted payment order is not, under section 28-4-610(1)[, Idaho Code], an authorized order of a customer identified as sender, but is effective as an order of the customer pursuant to section 28-4-610(2)[, Idaho Code], the following rules apply:

(a) By express written agreement, the receiving bank may limit the extent to which it is entitled to enforce or retain payment of the payment order.

(b) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by a person (i) entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure, or (ii) who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software, or the like.

(2) This section applies to amendments of payment orders to the same extent it applies to payment orders.

History.

I.C., § 28-4-611, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-203 in the uniform act.

The bracketed insertions in the introductory paragraph in subsection (1) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Some person will always be identified as the sender of a payment order. Acceptance of the order by the receiving bank is based on a belief by the bank that the order was authorized by the person identified as the sender. If the receiving bank is the beneficiary's bank acceptance means that the receiving bank is obliged to pay the beneficiary. If the receiving bank is not the beneficiary's bank, acceptance means that the receiving bank has executed the sender's order and is obliged to pay the bank that accepted the order issued in execution of the sender's order. In either case the receiving bank may suffer a loss unless it is entitled to enforce payment of the payment order that it accepted. If the person identified as the sender of the order refuses to pay on the ground that the order was not authorized by that person, what are the rights of the receiving bank? In the absence of a statute or agreement that specifically addresses the issue, the question usually will be resolved by the law of agency. In some cases, the law of agency works well. For example, suppose the receiving bank executes a payment order given by means of a letter apparently written by a corporation that is a customer of the bank and apparently signed by an officer of the corporation. If the receiving bank acts solely on the basis of the letter, the corporation is not bound as the sender of the payment order unless the signature was that of the officer and the officer was authorized to act for the corporation in the issuance of payment orders, or some other agency doctrine such as apparent authority or estoppel causes the corporation to be bound. Estoppel can be illustrated by the following example. Suppose P is aware that A, who is unauthorized to act for P, has fraudulently misrepresented to T that A is authorized to act for P. T believes A and is about to rely on the misrepresentation. If P does not notify T of the true facts although P could easily do so, P may be estopped from denying A's lack of authority. A similar result could follow if the failure to notify T is the result of negligence rather than a deliberate decision. Restatement, Second, Agency § 8B. Other equitable principles such as subrogation or restitution might also allow a receiving bank to recover with respect to an unauthorized payment order that it accepted. In *Gatoil (U.S.A.), Inc. v. Forest Hill State Bank*, 1 U.C.C. Rep. Serv. 2d 171 (D. Md. 1986), a joint venturer not authorized to order payments from the account of the joint venture, ordered a funds transfer from the account. The transfer paid a bona fide debt of the joint venture. Although the transfer was unauthorized the court refused to require recredit of the account because the joint venture suffered no loss.

The result can be rationalized on the basis of subrogation of the receiving bank to the right of the beneficiary of the funds transfer to receive the payment from the joint venture.

But in most cases these legal principles give the receiving bank very little protection in the case of an authorized payment order. Cases like those just discussed are not typical of the way that most payment orders are transmitted and accepted, and such cases are likely to become even less common. Given the large amount of the typical payment order, a prudent receiving bank will be unwilling to accept a payment order unless it has assurance that the order is what it purports to be. This assurance is normally provided by security procedures described in Section 4A-201.

In a very large percentage of cases covered by Article 4A, transmission of the payment order is made electronically. The receiving bank may be required to act on the basis of a message that appears on a computer screen. Common law concepts of authority of agent to bind principal are not helpful. There is no way of determining the identity or the authority of the person who caused the message to be sent. The receiving bank is not relying on the authority of any particular person to act for the purported sender. The case is not comparable to payment of a check by the drawee bank on the basis of a signature that is forged. Rather, the receiving bank relies on a security procedure pursuant to which the authenticity of the message can be "tested" by various devices which are designed to provide certainty that the message is that of the sender identified in the payment order. In the wire transfer business the concept of "authorized" is different from that found in agency law. In that business a payment order is treated as the order of the person in whose name it is issued if it is properly tested pursuant to a security procedure and the order passes the test.

Section 4A-202 reflects the reality of the wire transfer business. A person in whose name a payment order is issued is considered to be the sender of the order if the order is "authorized" as stated in subsection (a) or if the order is "verified" pursuant to a security procedure in compliance with subsection (b). If subsection (b) does not apply, the question of whether the customer is responsible for the order is determined by the law of agency. The issue is one of actual or apparent authority of the person who caused the order to be issued in the name of the customer. In some cases the law of agency might allow the customer to be bound by an unauthorized order if

conduct of the customer can be used to find an estoppel against the customer to deny that the order was unauthorized. If the customer is bound by the order under any of these agency doctrines, subsection (a) treats the order as authorized and thus the customer is deemed to be the sender of the order. In most cases, however, subsection (b) will apply. In that event there is no need to make an agency law analysis to determine authority. Under Section 4A-202, the issue of liability of the purported sender of the payment order will be determined by agency law only if the receiving bank did not comply with subsection (b).

2. The scope of Section 4A-202 can be illustrated by the following cases.

> **Case #1.** A payment order purporting to be that of Customer is received by Receiving Bank but the order was fraudulently transmitted by a person who had no authority to act for Customer.
>
> **Case #2.** An authentic payment order was sent by Customer, but before the order was received by Receiving Bank the order was fraudulently altered by an unauthorized person to change the beneficiary.
>
> **Case #3.** An authentic payment order was received by Receiving Bank, but before the order was executed by Receiving Bank a person who had no authority to act for Customer fraudulently sent a communication purporting to amend the order by changing the beneficiary.

In each case Receiving Bank acted on the fraudulent communication by accepting the payment order. These cases are all essentially similar and they are treated identically by Section 4A-202. In each case Receiving Bank acted on a communication that it thought was authorized by Customer when in fact the communication was fraudulent. No distinction is made between Case #1 in which Customer took no part at all in the transaction and Case #2 and Case #3 in which an authentic order was fraudulently altered or amended by an unauthorized person. If subsection (b) does not apply, each case is governed by subsection (a). If there are no additional facts on which an estoppel might be found, Customer is not responsible in Case #1 for the fraudulently issued payment order, in Case #2 for the fraudulent alteration or in Case #3 for the fraudulent amendment. Thus, in each case Customer is not liable to pay the order and Receiving Bank takes the loss. The only

remedy of Receiving Bank is to seek recovery from the person who received payment as beneficiary of the fraudulent order. If there was verification in compliance with subsection (b), Customer will take the loss unless Section 4A-203 applies.

3. Subsection (b) of Section 4A-202 is based on the assumption that losses due to fraudulent payment orders can best be avoided by the use of commercially reasonable security procedures, and that the use of such procedures should be encouraged. The subsection is designed to protect both the customer and the receiving bank. A receiving bank needs to be able to rely on objective criteria to determine whether it can safely act on a payment order. Employees of the bank can be trained to "test" a payment order according to the various steps specified in the security procedure. The bank is responsible for the acts of these employees. Subsection (b)(ii) requires the bank to prove that it accepted the payment order in good faith and "in compliance with the security procedure." If the fraud was not detected because the bank's employee did not perform the acts required by the security procedure, the bank has not complied. Subsection (b)(ii) also requires the bank to prove that it complied with any agreement or instruction that restricts acceptance of payment orders issued in the name of the customer. A customer may want to protect itself by imposing limitations on acceptance of payment orders by the bank. For example, the customer may prohibit the bank from accepting a payment order that is not payable from an authorized account, that exceeds the credit balance in specified accounts of the customer, or that exceeds some other amount. Another limitation may relate to the beneficiary. The customer may provide the bank with a list of authorized beneficiaries and prohibit acceptance of any payment order to a beneficiary not appearing on the list. Such limitations may be incorporated into the security procedure itself or they may be covered by a separate agreement or instruction. In either case, the bank must comply with the limitations if the conditions stated in subsection (b) are met. Normally limitations on acceptance would be incorporated into an agreement between the customer and the receiving bank, but in some cases the instruction might be unilaterally given by the customer. If standing instructions or an agreement state limitations on the ability of the receiving bank to act, provision must be made for later modification of the limitations. Normally this would be done by an agreement that specifies particular procedures to be followed. Thus, subsection (b) states that the

receiving bank is not required to follow an instruction that violates a written agreement. The receiving bank is not bound by an instruction unless it has adequate notice of it. Subsections (25), (26) and (27) of Section 1-201 [see § 28-1-202] apply.

Subsection (b)(i) assures that the interests of the customer will be protected by providing an incentive to a bank to make available to the customer a security procedure that is commercially reasonable. If a commercially reasonable security procedure is not made available to the customer, subsection (b)does not apply. The result is that subsection (a) applies and the bank acts at its peril in accepting a payment order that may be unauthorized. Prudent banking practice may require that security procedures be utilized in virtually all cases except for those in which personal contact between the customer and the bank eliminates the possibility of an unauthorized order. The burden of making available commercially reasonable security procedures is imposed on receiving banks because they generally determine what security procedures can be used and are in the best position to evaluate the efficacy of procedures offered to customers to combat fraud. The burden on the customer is to supervise its employees to assure compliance with the security procedure and to safeguard confidential security information and access to transmitting facilities so that the security procedure cannot be breached.

4. The principal issue that is likely to arise in litigation involving subsection (b) is whether the security procedure in effect when a fraudulent payment order was accepted was commercially reasonable. The concept of what is commercially reasonable in a given case is flexible. Verification entails labor and equipment costs that can vary greatly depending upon the degree of security that is sought. A customer that transmits very large numbers of payment orders in very large amounts may desire and may reasonably expect to be provided with state-of-the-art procedures that provide maximum security. But the expense involved may make use of a state-of-the-art procedure infeasible for a customer that normally transmits payment orders infrequently or in relatively low amounts. Another variable is the type of receiving bank. It is reasonable to require large money center banks to make available state-of-the-art security procedures. On the other hand, the same requirement may not be reasonable for a small country bank. A receiving bank might have several security procedures that are

designed to meet the varying needs of different customers. The type of payment order is another variable. For example, in a wholesale wire transfer, each payment order is normally transmitted electronically and individually. A testing procedure will be individually applied to each payment order. In funds transfers to be made by means of an automated clearing house many payment orders are incorporated into an electronic device such as a magnetic tape that is physically delivered. Testing of the individual payment orders is not feasible. Thus, a different kind of security procedure must be adopted to take into account the different mode of transmission.

The issue of whether a particular security procedure is commercially reasonable is a question of law. Whether the receiving bank complied with the procedure is a question of fact. It is appropriate to make the finding concerning commercial reasonability a matter of law because security procedures are likely to be standardized in the banking industry and a question of law standard leads to more predictability concerning the level of security that a bank must offer to its customers. The purpose of subsection (b) is to encourage banks to institute reasonable safeguards against fraud but not to make them insurers against fraud. A security procedure is not commercially unreasonable simply because another procedure might have been better or because the judge deciding the question would have opted for a more stringent procedure. The standard is not whether the security procedure is the best available. Rather it is whether the procedure is reasonable for the particular customer and the particular bank, which is a lower standard. On the other hand, a security procedure that fails to meet prevailing standards of good banking practice applicable to the particular bank should not be held to be commercially reasonable. Subsection (c) states factors to be considered by the judge in making the determination of commercial reasonableness. Sometimes an informed customer refuses a security procedure that is commercially reasonable and suitable for that customer and insists on using a higher-risk procedure because it is more convenient or cheaper. In that case, under the last sentence of subsection (c), the customer has voluntarily assumed the risk of failure of the procedure and cannot shift the loss to the bank. But this result follows only if the customer expressly agrees in writing to assume that risk. It is implicit in the last sentence of subsection (c) that a bank that accedes to the wishes of its customer in this regard is not acting in bad faith by so doing so long

as the customer is made aware of the risk. In all cases, however, a receiving bank cannot get the benefit of subsection (b) unless it has made available to the customer a security procedure that is commercially reasonable and suitable for use by that customer. In most cases, the mutual interest of bank and customer to protect against fraud should lead to agreement to a security procedure which is commercially reasonable.

5. The effect of Section 4A-202(b) is to place the risk of loss on the customer if an unauthorized payment order is accepted by the receiving bank after verification by the bank in compliance with a commercially reasonable security procedure. An exception to this result is provided by Section 4A-203(a)(2). The customer may avoid the loss resulting from such a payment order if the customer can prove that the fraud was not committed by a person described in that subsection. Breach of a commercially reasonable security procedure requires that the person committing the fraud have knowledge of how the procedure works and knowledge of codes, identifying devices, and the like. That person may also need access to transmitting facilities through an access device or other software in order to breach the security procedure. This confidential information must be obtained either from a source controlled by the customer or from a source controlled by the receiving bank. If the customer can prove that the person committing the fraud did not obtain the confidential information from an agent or former agent of the customer or from a source controlled by the customer, the loss is shifted to the bank. "Prove" is defined in Section 4A-105(a)(7). Because of bank regulation requirements, in this kind of case there will always be a criminal investigation as well as an internal investigation of the bank to determine the probable explanation for the breach of security. Because a funds transfer fraud usually will involve a very large amount of money, both the criminal investigation and the internal investigation are likely to be thorough. In some cases there may be an investigation by bank examiners as well. Frequently, these investigations will develop evidence of who is at fault and the cause of the loss. The customer will have access to evidence developed in these investigations and that evidence can be used by the customer in meeting its burden of proof.

6. The effect of Section 4A-202(b) may also be changed by an agreement meeting the requirements of Section 4A-203(a)(1). Some customers may be unwilling to take all or part of the risk of loss with respect to unauthorized

payment orders even if all of the requirements of Section 4A-202(b) are met. By virtue of Section 4A-203(a)(1), a receiving bank may assume all of the risk of loss with respect to unauthorized payment orders or the customer and bank may agree that losses from unauthorized payment orders are to be divided as provided in the agreement.

7. In a large majority of cases the sender of a payment order is a bank. In many cases in which there is a bank sender, both the sender and the receiving bank will be members of a funds transfer system over which the payment order is transmitted. Since Section 4A-202(f) does not prohibit a funds transfer system rule from varying rights and obligations under Section 4A-202, a rule of the funds transfer system can determine how loss due to an unauthorized payment order from a participating bank to another participating bank is to be allocated. A funds transfer system rule, however, cannot change the rights of a customer that is not a participating bank. § 4A-501(b). Section 4A-202(f) also prevents variation by agreement except to the extent stated.

§ 28-4-612. Refund of payment and duty of customer to report with respect to unauthorized payment order. — (a) If a receiving bank accepts a payment order issued in the name of its customer as sender which is:

(1) Not authorized and not effective as the order of the customer under section 28-4-610[, Idaho Code], or

(2) Not enforceable, in whole or in part, against the customer under section 28-4-611[, Idaho Code], the bank shall refund any payment of the payment order received from the customer to the extent the bank is not entitled to enforce payment and shall pay interest on the refundable amount calculated from the date the bank received payment to the date of the refund. However, the customer is not entitled to interest from the bank on the amount to be refunded if the customer fails to exercise ordinary care to determine that the order was not authorized by the customer and to notify the bank of the relevant facts within a reasonable time not exceeding ninety (90) days after the date the customer received notification from the bank that the order was accepted or that the customer's account was debited with respect to the order. The bank is not entitled to any recovery from the customer on account of a failure by the customer to give notification as stated in this section.

(b) Reasonable time under subsection (a) of this section may be fixed by agreement as stated in section 28-1-302(b)[, Idaho Code], but the obligation of a receiving bank to refund payment as stated in subsection (a) of this section may not otherwise be varied by agreement.

History.

I.C., § 28-4-612, as added by 1991, ch. 135, § 1, p. 295; am. 2004, ch. 43, § 34, p. 136.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-204 in the uniform act.

The bracketed insertions in paragraphs (a)(1) and (a)(2) and in subsection (b) were added by the compiler to conform to the statutory citation style.

Official Comment

1. With respect to unauthorized payment orders, in a very large percentage of cases a commercially reasonable security procedure will be in effect. Section 4A-204 applies only to cases in which (i) no commercially reasonable security procedure is in effect, (ii) the bank did not comply with a commercially reasonable security procedure that was in effect, (iii) the sender can prove, pursuant to Section 4A-203(a)(2), that the culprit did not obtain confidential security information controlled by the customer, or (iv) the bank, pursuant to Section 4A-203(a)(1) agreed to take all or part of the loss resulting from an unauthorized payment order. In each of these cases the bank takes the risk of loss with respect to an unauthorized payment order because the bank is not entitled to payment from the customer with respect to the order. The bank normally debits the customer's account or otherwise receives payment from the customer shortly after acceptance of the payment order. Subsection (a) of Section 4A-204 states that the bank must recredit the account or refund payment to the extent the bank is not entitled to enforce payment.

2. Section 4A-204 is designed to encourage a customer to promptly notify the receiving bank that it has accepted an unauthorized payment order. Since cases of unauthorized payment orders will almost always involve fraud, the bank's remedy is normally to recover from the beneficiary of the unauthorized order if the beneficiary was party to the fraud. This remedy may not be worth very much and it may not make any difference whether or not the bank promptly learns about the fraud. But in some cases prompt notification may make it easier for the bank to recover some part of its loss from the culprit. The customer will routinely be notified of the debit to its account with respect to an unauthorized order or will otherwise be notified of acceptance of the order. The customer has a duty to exercise ordinary care to determine that the order was unauthorized after it has received notification from the bank, and to advise the bank of the relevant facts within a reasonable time not exceeding 90 days after receipt of notification. Reasonable time is not defined and it may depend on the facts of the particular case. If a payment order for $1,000,000 is wholly

unauthorized, the customer should normally discover it in far less than 90 days. If a $1,000,000 payment order was authorized but the name of the beneficiary was fraudulently changed, a much longer period may be necessary to discover the fraud. But in any event, if the customer delays more than 90 days the customer's duty has not been met. The only consequence of a failure of the customer to perform this duty is a loss of interest on the refund payable by the bank. A customer that acts promptly is entitled to interest from the time the customer's account was debited or the customer otherwise made payment. The rate of interest is stated in Section 4A-506. If the customer fails to perform the duty, no interest is recoverable for any part of the period before the bank learns that it accepted an unauthorized order. But the bank is not entitled to any recovery from the customer based on negligence for failure to inform the bank. Loss of interest is in the nature of a penalty on the customer designed to provide an incentive for the customer to police its account. There is no intention to impose a duty on the customer that might result in shifting loss from the unauthorized order to the customer.

§ 28-4-613. Erroneous payment orders. — (1) If an accepted payment order was transmitted pursuant to a security procedure for the detection of error and the payment order (i) erroneously instructed payment to a beneficiary not intended by the sender, (ii) erroneously instructed payment in an amount greater than the amount intended by the sender, or (iii) was an erroneously transmitted duplicate of a payment order previously sent by the sender, the following rules apply:

(a) If the sender proves that the sender or a person acting on behalf of the sender pursuant to section 28-4-614, Idaho Code, complied with the security procedure and that the error would have been detected if the receiving bank had also complied, the sender is not obliged to pay the order to the extent stated in paragraphs (b) and (c) of this subsection.

(b) If the funds transfer is completed on the basis of an erroneous payment order described in clause (i) or (iii) of this subsection, the sender is not obliged to pay the order and the receiving bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(c) If the funds transfer is completed on the basis of a payment order described in clause (ii) of this subsection of this section, the sender is not obliged to pay the order to the extent the amount received by the beneficiary is greater than the amount intended by the sender. In that case, the receiving bank is entitled to recover from the beneficiary the excess amount received to the extent allowed by the law governing mistake and restitution.

(2) If (i) the sender of an erroneous payment order described in subsection (1) of this section is not obliged to pay all or part of the order, and (ii) the sender receives notification from the receiving bank that the order was accepted by the bank or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care, on the basis of information available to the sender, to discover the error with respect to the order and to advise the bank of the relevant facts within a reasonable time, not exceeding ninety (90) days, after the bank's notification was received by the sender. If the bank proves that the sender

failed to perform that duty, the sender is liable to the bank for the loss the bank proves it incurred as a result of the failure, but the liability of the sender may not exceed the amount of the sender's order.

(3) This section applies to amendments to payment orders to the same extent it applies to payment orders.

History.

I.C., § 28-4-613, as added by 1991, ch. 135, § 1, p. 295; am. 2014, ch. 97, § 8, p. 265; am. 2020, ch. 82, § 16, p. 174.

STATUTORY NOTES

Amendments.

The 2014 amendment, by ch. 97, inserted "Idaho Code" in paragraph (1)(a).

The 2020 amendment, by ch. 82, in subsection (1), substituted "paragraphs (b) and (c) of this subsection" for "subsections (2) and (3) of this section" at the end of paragraph (a); substituted "of this subsection" for "of subsection (1) of this section" near the beginning of paragraph (b) and substituted "of this subsection of this section" for "of subsection (1) of this section" near the beginning of paragraph (c).

Compiler's Notes.

This section is designated as section 4A-205 in the uniform act.

Official Comment

1. This section concerns error in the content or in the transmission of payment orders. It deals with three kinds of error. *Case #1*. The order identifies a beneficiary not intended by the sender. For example, Sender intends to wire funds to a beneficiary identified only by an account number. The wrong account number is stated in the order. *Case #2*. The error is in the amount of the order. For example, Sender intends to wire $1,000 to Beneficiary. Through error, the payment order instructs payment of $1,000,000. *Case #3*. A payment order is sent to the receiving bank and then, by mistake, the same payment order is sent to the receiving bank again. In Case #3, the receiving bank may have no way of knowing whether

the second order is a duplicate of the first or is another order. Similarly, in Case #1 and Case #2, the receiving bank may have no way of knowing that the error exists. In each case, if this section does not apply and the funds transfer is completed, Sender is obliged to pay the order. Section 4A-402. Sender's remedy, based on payment by mistake, is to recover from the beneficiary that received payment.

Sometimes, however, transmission of payment orders of the sender to the receiving bank is made pursuant to a security procedure designed to detect one or more of the errors described above. Since "security procedure" is defined by Section 4A-201 as "a procedure established by agreement of a customer and a receiving bank for the purpose of * detecting error *," Section 4A-205 does not apply if the receiving bank and the customer did not agree to the establishment of a procedure for detecting error. A security procedure may be designed to detect an account number that is not one to which Sender normally makes payment. In that case, the security procedure may require a special verification that payment to the stated account number was intended. In the case of dollar amounts, the security procedure may require different codes for different dollar amounts. If a $1,000,000 payment order contains a code that is inappropriate for that amount, the error in amount should be detected. In the case of duplicate orders, the security procedure may require that each payment order be identified by a number or code that applies to no other order. If the number or code of each payment order received is registered in a computer base, the receiving bank can quickly identify a duplicate order. The three cases covered by this section are essentially similar. In each, if the error is not detected, some beneficiary will receive funds that the beneficiary was not intended to receive. If this section applies, the risk of loss with respect to the error of the sender is shifted to the bank which has the burden of recovering the funds from the beneficiary. The risk of loss is shifted to the bank only if the sender proves that the error would have been detected if there had been compliance with the procedure and that the sender (or an agent under Section 4A-206) complied. In the case of a duplicate order or a wrong beneficiary, the sender doesn't have to pay the order. In the case of an overpayment, the sender does not have to pay the order to the extent of the overpayment. If subsection (a)(1) applies, the position of the receiving bank is comparable to that of a receiving bank that erroneously executes a payment order as stated in Section 4A-303. However, failure of the sender

to timely report the error is covered by Section 4A-205(b) rather than by Section 4A-304 which applies only to erroneous execution under Section 4A-303. A receiving bank to which the risk of loss is shifted by subsection (a)(1) or (2) is entitled to recover the amount erroneously paid to the beneficiary to the extent allowed by the law of mistake and restitution. Rights of the receiving bank against the beneficiary are similar to those of a receiving bank that erroneously executes a payment order as stated in Section 4A-303. Those rights are discussed in Comment 2 to Section 4A-303.

2. A security procedure established for the purpose of detecting error is not effective unless both sender and receiving bank comply with the procedure. Thus, the bank undertakes a duty of complying with the procedure for the benefit of the sender. This duty is recognized in subsection (a)(1). The loss with respect to the sender's error is shifted to the bank if the bank fails to comply with the procedure and the sender (or an agent under Section 4A-206) does comply. Although the customer may have been negligent in transmitting the erroneous payment order, the loss is put on the bank on a last-clear-chance theory. A similar analysis applies to subsection (b). If the loss with respect to an error is shifted to the receiving bank and the sender is notified by the bank that the erroneous payment order was accepted, the sender has a duty to exercise ordinary care to discover the error and notify the bank of the relevant facts within a reasonable time not exceeding 90 days. If the bank can prove that the sender failed in this duty it is entitled to compensation for the loss incurred as a result of the failure. Whether the bank is entitled to recover from the sender depends upon whether the failure to give timely notice would have made any difference. If the bank could not have recovered from the beneficiary that received payment under the erroneous payment order even if timely notice had been given, the sender's failure to notify did not cause any loss of the bank.

3. Section 4A-205 is subject to variation by agreement under Section 4A-501. Thus, if a receiving bank and its customer have agreed to a security procedure for detection of error, the liability of the receiving bank for failing to detect an error of the customer as provided in Section 4A-205 may be varied as provided in an agreement of the bank and the customer.

§ 28-4-614. Transmission of payment order through funds — Transfer or other communication system. — (1) If a payment order addressed to a receiving bank is transmitted to a funds-transfer system or other third-party communication system for transmittal to the bank, the system is deemed to be an agent of the sender for the purpose of transmitting the payment order to the bank. If there is a discrepancy between the terms of the payment order transmitted to the system and the terms of the payment order transmitted by the system to the bank, the terms of the payment order of the sender are those transmitted by the system. This section does not apply to a funds-transfer system of the Federal Reserve banks.

(2) This section applies to cancellations and amendments of payment orders to the same extent it applies to payment orders.

History.

I.C., § 28-4-614, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-206 in the uniform act.

Official Comment 1. A payment order may be issued to a receiving bank directly by delivery of a writing or electronic device or by an oral or electronic communication. If an agent of the sender is employed to transmit orders on behalf of the sender, the sender is bound by the order transmitted by the agent on the basis of agency law. Section 4A-206 is an application of that principle to cases in which a funds transfer or communication system acts as an intermediary in transmitting the sender's order to the receiving bank. The intermediary is deemed to be an agent of the sender for the purpose of transmitting payment orders and related messages for the sender. Section 4A-206 deals with error by the intermediary.

2. Transmission by an automated clearing house of an association of banks other than the Federal Reserve Banks is an example of a transaction covered by Section 4A-206. Suppose Originator orders Originator's Bank to cause a large number of payments to be made to many accounts in banks in various parts of the country. These payment orders are electronically transmitted to Originator's Bank and stored in an electronic device that is held by Originator's Bank. Or, transmission of the various payment orders is made by delivery to Originator's Bank of an electronic device containing the instruction to the bank. In either case the terms of the various payment orders by Originator are determined by the information contained in the electronic device. In order to execute the various orders, the information in the electronic device must be processed. For example, if some of the orders are for payments to accounts in Bank X and some to accounts in Bank Y, Originator's Bank will execute these orders of Originator by issuing a series of payment orders to Bank X covering all payments to accounts in that bank, and by issuing a series of payment orders to Bank Y covering all payments to accounts in that bank. The orders to Bank X may be transmitted together by means of an electronic device, and those to Bank Y may be included in another electronic device. Typically, this processing is done by an automated clearing house acting for a group of banks including Originator's Bank. The automated clearing house is a funds transfer system. Section 4A-105(a)(5). Originator's Bank delivers Originator's electronic device or transmits the information contained in the device to the funds transfer system for processing into payment orders of Originator's Bank to the appropriate beneficiary's banks. The processing may result in an erroneous payment order. Originator's Bank, by use of Originator's electronic device, may have given information to the funds transfer system instructing payment of $100,000 to an account in Bank X, but because of human error or an equipment malfunction the processing may have converted that instruction into an instruction to Bank X to make a payment of $1,000,000. Under Section 4A-206, Originator's Bank issued a payment order for $1,000,000 to Bank X when the erroneous information was sent to Bank X. Originator's Bank is responsible for the error of the automated clearing house. The liability of the funds transfer system that made the error is not governed by Article 4A. It is left to the law of contract, a funds transfer system rule, or other applicable law.

In the hypothetical case just discussed, if the automated clearing house is operated by a Federal Reserve Bank, the analysis is different. Section 4A-206 does not apply. Originator's Bank will execute Originator's payment orders by delivery or transmission of the electronic information to the Federal Reserve Bank for processing. The result is that Originator's Bank has issued payment orders to the Federal Reserve Bank which, in this case, is acting as an intermediary bank. When the Federal Reserve Bank has processed the information given to it by Originator's Bank it will issue payment orders to the various beneficiary's banks. If the processing results in an erroneous payment order, the Federal Reserve Bank has erroneously executed the payment order of Originator's Bank and the case is governed by Section 4A-303.

§ 28-4-615. Misdescription of beneficiary. — (1) Subject to subsection (2) of this section, if, in a payment order received by the beneficiary's bank, the name, bank account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

(2) If a payment order received by the beneficiary's bank identifies the beneficiary both by name and by an identifying or bank account number and the name and number identify different persons, the following rules apply:

(a) Except as otherwise provided in subsection (3) of this section, if the beneficiary's bank does not know that the name and number refer to different persons, it may rely on the number as the proper identification of the beneficiary of the order. The beneficiary's bank need not determine whether the name and number refer to the same person.

(b) If the beneficiary's bank pays the person identified by name or knows that the name and number identify different persons, no person has rights as beneficiary except the person paid by the beneficiary's bank if that person was entitled to receive payment from the originator of the funds transfer. If no person has rights as beneficiary, acceptance of the order cannot occur.

(3) If (i) a payment order described in subsection (2) of this section is accepted, (ii) the originator's payment order described the beneficiary inconsistently by name and number, and (iii) the beneficiary's bank pays the person identified by number as permitted in subsection (2)(a) of this section, the following rules apply:

(a) If the originator is a bank, the originator is obliged to pay its order.

(b) If the originator is not a bank and proves that the person identified by number was not entitled to receive payment from the originator, the originator is not obliged to pay its order unless the originator's bank proves that the originator, before acceptance of the originator's order, had notice that payment of a payment order issued by the originator might be

made by the beneficiary's bank on the basis of an identifying or bank account number even if it identifies a person different from the named beneficiary. Proof of notice may be made by any admissible evidence. The originator's bank satisfies the burden of proof if it proves that the originator, before the payment order was accepted, signed a writing stating the information to which the notice relates.

(4) In a case governed by the provisions of subsection (2)(a) of this section, if the beneficiary's bank rightfully pays the person identified by number and that person was not entitled to receive payment from the originator, the amount paid may be recovered from that person to the extent allowed by the law governing mistake and restitution as follows:

(a) If the originator is obliged to pay its payment order as stated in subsection (3) of this section, the originator has the right to recover.

(b) If the originator is not a bank and is not obliged to pay its payment order, the originator's bank has the right to recover.

History.

I.C., § 28-4-615, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-207 in the uniform act.

Official Comment

1. Subsection (a) deals with the problem of payment orders issued to the beneficiary's bank for payment to nonexistent or unidentifiable persons or accounts. Since it is not possible in that case for the funds transfer to be completed, subsection (a) states that the order cannot be accepted. Under Section 4A-402(c), a sender of a payment order is not obliged to pay its order unless the beneficiary's bank accepts a payment order instructing payment to the beneficiary of that sender's order. Thus, if the beneficiary of a funds transfer is nonexistent or unidentifiable, each sender in the funds transfer that has paid its payment order is entitled to get its money back.

2. Subsection (b), which takes precedence over subsection (a), deals with the problem of payment orders in which the description of the beneficiary does not allow identification of the beneficiary because the beneficiary is described by name and by an identifying number or an account number and the name and number refer to different persons. A very large percentage of payment orders issued to the beneficiary's bank by another bank are processed by automated means using machines capable of reading orders on standard formats that identify the beneficiary by an identifying number or the number of a bank account. The processing of the order by the beneficiary's bank and the crediting of the beneficiary's account are done by use of the identifying or bank account number without human reading of the payment order itself. The process is comparable to that used in automated payment of checks. The standard format, however, may also allow the inclusion of the name of the beneficiary and other information which can be useful to the beneficiary's bank and the beneficiary but which plays no part in the process of payment. If the beneficiary's bank has both the account number and name of the beneficiary supplied by the originator of the funds transfer, it is possible for the beneficiary's bank to determine whether the name and number refer to the same person, but if a duty to make that determination is imposed on the beneficiary's bank the benefits of automated payment are lost. Manual handling of payment orders is both expensive and subject to human error. If payment orders can be handled on an automated basis there are substantial economies of operation and the possibility of clerical error is reduced. Subsection (b) allows banks to utilize automated processing by allowing banks to act on the basis of the number without regard to the name if the bank does not know that the name and number refer to different persons. "Know" is defined in Section 1-201(25) [see § 28-1-202)] to mean actual knowledge, and Section 1-201(27) [see § 28-1-202] states rules for determining when an organization has knowledge of information received by the organization. The time of payment is the pertinent time at which knowledge or lack of knowledge must be determined.

Although the clear trend is for beneficiary's banks to process payment orders by automated means, Section 4A-207 is not limited to cases in which processing is done by automated means. A bank that processes by semi-automated means or even manually may rely on number as stated in Section 4A-207.

In cases covered by subsection (b) the erroneous identification would in virtually all cases be the identifying or bank account number. In the typical case the error is made by the originator of the funds transfer. The originator should know the name of the person who is to receive payment and can further identify that person by an address that would normally be known to the originator. It is not unlikely, however, that the originator may not be sure whether the identifying or account number refers to the person the originator intends to pay. Subsection (b)(1) deals with the typical case in which the beneficiary's bank pays on the basis of the account number and is not aware at the time of payment that the named beneficiary is not the holder of the account which was paid. In some cases the false number will be the result of error by the originator. In other cases fraud is involved. For example, Doe is the holder of shares in Mutual Fund. Thief, impersonating Doe, requests redemption of the shares and directs Mutual Fund to wire the redemption proceeds to Doe's account #12345 in Beneficiary's Bank. Mutual Fund originates a funds transfer by issuing a payment order to Originator's Bank to make the payment to Doe's account #12345 in Beneficiary's Bank. Originator's Bank executes the order by issuing a conforming payment order to Beneficiary's Bank which makes payment to account #12345. That account is the account of Roe rather than Doe. Roe might be a person acting in concert with Thief or Roe might be an innocent third party. Assume that Roe is a gem merchant that agreed to sell gems to Thief who agreed to wire the purchase price to Roe's account in Beneficiary's Bank. Roe believed that the credit to Roe's account was a transfer of funds from Thief and released the gems to Thief in good faith in reliance on the payment. The case law is unclear on the responsibility of a beneficiary's bank in carrying out a payment order in which the identification of the beneficiary by name and number is conflicting. See *Securities Fund Services, Inc. v. American National Bank*, 542 F. Supp. 323 (N.D. Ill. 1982) and *Bradford Trust Co. v. Texas American Bank*, 790 F.2d 407 (5th Cir. 1986). Section 4A-207 resolves the issue.

If Beneficiary's Bank did not know about the conflict between the name and number, subsection (b)(1) applies. Beneficiary's Bank has no duty to determine whether there is a conflict and it may rely on the number as the proper identification of the beneficiary of the order. When it accepts the order, it is entitled to payment from Originator's Bank. Section 4A-402(b). On the other hand, if Beneficiary's Bank knew about the conflict between

the name and number and nevertheless paid Roe, subsection (b)(2) applies. Under that provision, acceptance of the payment order of Originator's Bank did not occur because there is no beneficiary of that order. Since acceptance did not occur Originator's Bank is not obliged to pay Beneficiary's Bank. Section 4A-402(b). Similarly, Mutual Fund is excused from its obligation to pay Originator's Bank. Section 4A-402(c). Thus, Beneficiary's Bank takes the loss. Its only cause of action is against Thief. Roe is not obliged to return the payment to the beneficiary's bank because Roe received the payment in good faith and for value. Article 4A makes irrelevant the issue of whether Mutual Fund was or was not negligent in issuing its payment order.

3. Normally, subsection (b)(1) will apply to the hypothetical case discussed in Comment 2. Beneficiary's Bank will pay on the basis of the number without knowledge of the conflict. In that case subsection (c) places the loss on either Mutual Fund or Originator's Bank. It is not unfair to assign the loss to Mutual Fund because it is the person who dealt with the impostor and it supplied the wrong account number. It could have avoided the loss if it had not used an account number that it was not sure was that of Doe. Mutual Fund, however, may not have been aware of the risk involved in giving both name and number. Subsection (c) is designed to protect the originator, Mutual Fund, in this case. Under that subsection, the originator is responsible for the inconsistent description of the beneficiary if it had notice that the order might be paid by the beneficiary's bank on the basis of the number. If the originator is a bank, the originator always has that responsibility. The rationale is that any bank should know how payment orders are processed and paid. If the originator is not a bank, the originator's bank must prove that its customer, the originator, had notice. Notice can be proved by any admissible evidence, but the bank can always prove notice by providing the customer with a written statement of the required information and obtaining the customer's signature to the statement. That statement will then apply to any payment order accepted by the bank thereafter. The information need not be supplied more than once.

In the hypothetical case if Originator's Bank made the disclosure stated in the last sentence of subsection (c)(2), Mutual Fund must pay Originator's Bank. Under subsection (d)(1), Mutual Fund has an action to recover from Roe if recovery from Roe is permitted by the law governing mistake and

restitution. Under the assumed facts Roe should be entitled to keep the money as a person who took it in good faith and for value since it was taken as payment for the gems. In that case, Mutual Fund's only remedy is against Thief. If Roe was not acting in good faith, Roe has to return the money to Mutual Fund. If Originator's Bank does not prove that Mutual Fund had notice as stated in subsection (c)(2), Mutual Fund is not required to pay Originator's Bank. Thus, the risk of loss falls on Originator's Bank whose remedy is against Roe or Thief as stated above. Subsection (d)(2).

§ 28-4-616. Misdescription of intermediary bank or beneficiary's bank.

— (1) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank only by an identifying number.

(a) The receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank and need not determine whether the number identifies a bank.

(b) The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(2) This subsection applies to a payment order identifying an intermediary bank or the beneficiary's bank both by name and an identifying number if the name and number identify different persons.

(a) If the sender is a bank, the receiving bank may rely on the number as the proper identification of the intermediary or beneficiary's bank if the receiving bank, when it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person or whether the number refers to a bank. The sender is obliged to compensate the receiving bank for any loss and expenses incurred by the receiving bank as a result of its reliance on the number in executing or attempting to execute the order.

(b) If the sender is not a bank and the receiving bank proves that the sender, before the payment order was accepted, had notice that the receiving bank might rely on the number as the proper identification of the intermediary or beneficiary's bank even if it identifies a person different from the bank identified by name, the rights and obligations of the sender and the receiving bank are governed by subsection (2)(a) of this section, as though the sender were a bank. Proof of notice may be made by any admissible evidence. The receiving bank satisfies the burden of proof if it proves that the sender, before the payment order was

accepted, signed a writing stating the information to which the notice relates.

(c) Regardless of whether the sender is a bank, the receiving bank may rely on the name as the proper identification of the intermediary or beneficiary's bank if the receiving bank, at the time it executes the sender's order, does not know that the name and number identify different persons. The receiving bank need not determine whether the name and number refer to the same person.

(d) If the receiving bank knows that the name and number identify different persons, reliance on either the name or the number in executing the sender's payment order is a breach of the obligation stated in section 28-4-622(1)(a)[, Idaho Code].

History.

I.C., § 28-4-616, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion at the end of paragraph (2)(d) was added by the compiler to conform to the statutory citation style.

This section is designated as section 4A-208 in the uniform act.

Official Comment

1. This section addresses an issue similar to that addressed by Section 4A-207. Because of automation in the processing of payment orders, a payment order may identify the beneficiary's bank or an intermediary bank by an identifying number. The bank identified by number might or might not also be identified by name. The following two cases illustrate Section 4A-208(a) and (b):

> **Case #1.** Originator's payment order to Originator's Bank identifies the beneficiary's bank as Bank A and instructs payment to Account #12345 in that bank. Originator's Bank executes Originator's order by issuing a payment order to Intermediary Bank. In the payment order of Originator's Bank the beneficiary's bank is identified as Bank A but is

also identified by number, #67890. The identifying number refers to Bank B rather than Bank A. If processing by Intermediary Bank of the payment order of Originator's Bank is done by automated means, Intermediary Bank, in executing the order, will rely on the identifying number and will issue a payment order to Bank B rather than Bank A. If there is an Account #12345 in Bank B, the payment order of Intermediary Bank would normally be accepted and payment would be made to a person not intended by Originator. In this case, Section 4A-208(b)(1) puts the risk of loss on Originator's Bank. Intermediary Bank may rely on the number #67890 as the proper identification of the beneficiary's bank. Intermediary Bank has properly executed the payment order of Originator's Bank. By using the wrong number to describe the beneficiary's bank, Originator's Bank has improperly executed Originator's payment order because the payment order of Originator's Bank provides for payment to the wrong beneficiary, the holder of Account #12345 in Bank B rather than the holder of Account #12345 in Bank A. Section 4A-302(a)(1) and Section 4A-303(c). Originator's Bank is not entitled to payment from Originator but is required to pay Intermediary Bank. Section 4A-303(c) and Section 4A-402(c). Intermediary Bank is also entitled to compensation for any loss and expenses resulting from the error by Originator's Bank.

If there is no Account #12345 in Bank B, the result is that there is no beneficiary of the payment order issued by Originator's Bank and the funds transfer will not be completed. Originator's Bank is not entitled to payment from Originator and Intermediary Bank is not entitled to payment from Originator's Bank. Section 4A-402(c). Since Originator's Bank improperly executed Originator's payment order it may be liable for damages under Section 4A-305. As stated above, Intermediary Bank is entitled to compensation for loss and expenses resulting from the error by Originator's Bank.

Case #2. Suppose the same payment order by Originator to Originator's Bank as in Case #1. In executing the payment order Originator's Bank issues a payment order to Intermediary Bank in which the beneficiary's bank is identified only by number, #67890. That number does not refer to Bank A. Rather, it identifies a person that is not a bank. If processing by Intermediary Bank of the payment

order of Originator's Bank is done by automated means, Intermediary Bank will rely on the number #67890 to identify the beneficiary's bank. Intermediary Bank has no duty to determine whether the number identifies a bank. The funds transfer cannot be completed in this case because no bank is identified as the beneficiary's bank. Subsection (a) puts the risk of loss on Originator's Bank. Originator's Bank is not entitled to payment from Originator. Section 4A-402(c). Originator's Bank has improperly executed Originator's payment order and may be liable for damages under Section 4A-305. Originator's Bank is obliged to compensate Intermediary Bank for loss and expenses resulting from the error by Originator's Bank.

Subsection (a) also applies if #67890 identifies a bank, but the bank is not Bank A. Intermediary Bank may rely on the number as the proper identification of the beneficiary's bank. If the bank to which Intermediary Bank sends its payment order accepts the order, Intermediary Bank is entitled to payment from Originator's Bank, but Originator's Bank is not entitled to payment from Originator. The analysis is similar to that in Case #1.

2. Subsection (b)(2) of Section 4A-208 addresses cases in which an erroneous identification of a beneficiary's bank or intermediary bank by name and number is made in a payment order of a sender that is not a bank. Suppose Originator issues a payment order to Originator's Bank that instructs that bank to use an intermediary bank identified as Bank A and by an identifying number, #67890. The identifying number refers to Bank B. Originator intended to identify Bank A as intermediary bank. If Originator's Bank relied on the number and issued a payment order to Bank B the rights of Originator's Bank depend upon whether the proof of notice stated in subsection (b)(2) is made by Originator's Bank. If proof is made, Originator's Bank's rights are governed by subsection (b)(1) of Section 4A-208. Originator's Bank is not liable for breach of Section 4A-302(a)(1) and is entitled to compensation from Originator for any loss and expenses resulting from Originator's error. If notice is not proved, Originator's Bank may not rely on the number in executing Originator's payment order. Since Originator's Bank does not get the benefit of subsection (b)(1) in that case, Originator's Bank improperly executed Originator's payment order and is in breach of the obligation stated in Section 4A-302(a)(1). If notice is not

given, Originator's Bank can rely on the name if it is not aware of the conflict in name and number. Subsection (b)(3).

3. Although the principal purpose of Section 4A-208 is to accommodate automated processing of payment orders, Section 4A-208 applies regardless of whether processing is done by automation, semi-automated means or manually.

§ 28-4-617. Acceptance of payment order. — (1) Subject to subsection (4) of this section, a receiving bank other than the beneficiary's bank accepts a payment order when it executes the order.

(2) Subject to subsections (3) and (4) of this section, a beneficiary's bank accepts a payment order at the earliest of the following times:

(a) when the bank (i) pays the beneficiary as stated in section 28-4-630(1) or 28-4-630(2)[, Idaho Code], or (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order unless the notice indicates that the bank is rejecting the order or that funds with respect to the order may not be withdrawn or used until receipt of payment from the sender of the order;

(b) when the bank receives payment of the entire amount of the sender's order pursuant to section 28-4-628(1)(a) or 28-4-628(1)(b)[, Idaho Code]; or

(c) the opening of the next funds-transfer business day of the bank following the payment date of the order if, at that time, the amount of the sender's order is fully covered by a withdrawable credit balance in an authorized account of the sender or the bank has otherwise received full payment from the sender, unless the order was rejected before that time or is rejected within (i) one (1) hour after that time, or (ii) one (1) hour after the opening of the next business day of the sender following the payment date if that time is later. If notice of rejection is received by the sender after the payment date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the payment date to the day the sender receives notice or learns that the order was not accepted, counting that day as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest payable is reduced accordingly.

(3) Acceptance of a payment order cannot occur before the order is received by the receiving bank. Acceptance does not occur under subsection (2)(b) or (2)(c) of this section if the beneficiary of the payment order does

not have an account with the receiving bank, the account has been closed, or the receiving bank is not permitted by law to receive credits for the beneficiary's account.

(4) A payment order issued to the originator's bank cannot be accepted until the payment date if the bank is the beneficiary's bank, or the execution date if the bank is not the beneficiary's bank. If the originator's bank executes the originator's payment order before the execution date or pays the beneficiary of the originator's payment order before the payment date and the payment order is subsequently cancelled pursuant to section 28-4-619(2)[, Idaho Code], the bank may recover from the beneficiary any payment received to the extent allowed by the law governing mistake and restitution.

History.

I.C., § 28-4-617, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-209 in the uniform act.

The bracketed insertions in paragraphs (2)(a) and (2)(b) and in subsection (4) were added by the compiler to conform to the statutory citation style.

Official Comment

1. This section treats the sender's payment order as a request by the sender to the receiving bank to execute or pay the order and that request can be accepted or rejected by the receiving bank. Section 4A-209 defines when acceptance occurs. Section 4A-210 covers rejection. Acceptance of the payment order imposes an obligation on the receiving bank to the sender if the receiving bank is not the beneficiary's bank, or to the beneficiary if the receiving bank is the beneficiary's bank. These obligations are stated in Section 4A-302 and Section 4A-404.

2. Acceptance by a receiving bank other than the beneficiary's bank is defined in Section 4A-209(a). That subsection states the only way that a bank other than the beneficiary's bank can accept a payment order. A

payment order to a bank other than the beneficiary's bank is, in effect, a request that the receiving bank execute the sender's order by issuing a payment order to the beneficiary's bank or to an intermediary bank. Normally, acceptance occurs at the time of execution, but there is an exception stated in subsection (d) and discussed in Comment 9. Execution occurs when the receiving bank "issues a payment order intended to carry out" the sender's order. Section 4A-301(a). In some cases the payment order issued by the receiving bank may not conform to the sender's order. For example, the receiving bank might make a mistake in the amount of its order, or the order might be issued to the wrong beneficiary's bank or for the benefit of the wrong beneficiary. In all of these cases there is acceptance of the sender's order by the bank when the receiving bank issues its order intended to carry out the sender's order, even though the bank's payment order does not in fact carry out the instruction of the sender. Improper execution of the sender's order may lead to liability to the sender for damages or it may mean that the sender is not obliged to pay its payment order. These matters are covered in Section 4A-303, Section 4A-305, and Section 4A-402.

3. A receiving bank has no duty to accept a payment order unless the bank makes an agreement, either before or after issuance of the payment order, to accept it, or acceptance is required by a funds transfer system rule. If the bank makes such an agreement it incurs a contractual obligation based on the agreement and may be held liable for breach of contract if a failure to execute violates the agreement. In many cases a bank will enter into an agreement with its customer to govern the rights and obligations of the parties with respect to payment orders issued to the bank by the customer or, in cases in which the sender is also a bank, there may be a funds transfer system rule that governs the obligations of a receiving bank with respect to payment orders transmitted over the system. Such agreements or rules can specify the circumstances under which a receiving bank is obliged to execute a payment order and can define the extent of liability of the receiving bank for breach of the agreement or rule. Section 4A-305(d) states the liability for breach of an agreement to execute a payment order.

4. In the case of a payment order issued to the beneficiary's bank, acceptance is defined in Section 4A-209(b). The function of a beneficiary's

bank that receives a payment order is different from that of a receiving bank that receives a payment order for execution. In the typical case, the beneficiary's bank simply receives payment from the sender of the order, credits the account of the beneficiary and notifies the beneficiary of the credit. Acceptance by the beneficiary's bank does not create any obligation to the sender. Acceptance by the beneficiary's bank means that the bank is liable to the beneficiary for the amount of the order. Section 4A-404(a). There are three ways in which the beneficiary's bank can accept a payment order which are described in the following comments.

5. Under Section 4A-209(b)(1), the beneficiary's bank can accept a payment order by paying the beneficiary. In the normal case of crediting an account of the beneficiary, payment occurs when the beneficiary is given notice of the right to withdraw the credit, the credit is applied to a debt of the beneficiary, or "funds with respect to the order" are otherwise made available to the beneficiary. Section 4A-405(a). The quoted phrase covers cases in which funds are made available to the beneficiary as a result of receipt of a payment order for the benefit of the beneficiary but the release of funds is not expressed as payment of the order. For example, the beneficiary's bank might express a release of funds equal to the amount of the order as a "loan" that will be automatically repaid when the beneficiary's bank receives payment by the sender of the order. If the release of funds is designated as a loan pursuant to a routine practice of the bank, the release is conditional payment of the order rather than a loan, particularly if normal incidents of a loan such as the signing of a loan agreement or note and the payment of interest are not present. Such a release of funds is payment to the beneficiary under Section 4A-405(a). Under Section 4A-405(c) the bank cannot recover the money from the beneficiary if the bank does not receive payment from the sender of the payment order that it accepted. Exceptions to this rule are stated in § 4A-405(d) and (e). The beneficiary's bank may also accept by notifying the beneficiary that the order has been received. "Notifies" is defined in Section 1-201(26) [see § 28-1-202]. In some cases a beneficiary's bank will receive a payment order during the day but settlement of the sender's obligation to pay the order will not occur until the end of the day. If the beneficiary's bank wants to defer incurring liability to the beneficiary until the beneficiary's bank receives payment, it can do so. The beneficiary's bank incurs no liability to the beneficiary with respect to a payment order that it

receives until it accepts the order. If the bank does not accept pursuant to subsection (b)(1), acceptance does not occur until the end of the day when the beneficiary's bank receives settlement. If the sender settles, the payment order will be accepted under subsection (b)(2) and the funds will be released to the beneficiary the next morning. If the sender doesn't settle, no acceptance occurs. In either case the beneficiary's bank suffers no loss.

6. In most cases the beneficiary's bank will receive a payment order from another bank. If the sender is a bank and the beneficiary's bank receives payment from the sender by final settlement through the Federal Reserve System or a funds transfer system (Section 4A-403(a)(1)) or, less commonly, through credit to an account of the beneficiary's bank with the sender or another bank (Section 4A-403(a)(2)), acceptance by the beneficiary's bank occurs at the time payment is made. Section 4A-209(b)(2). A minor exception to this rule is stated in Section 4A-209(c). Section 4A-209(b)(2) results in automatic acceptance of payment orders issued to a beneficiary's bank by means of Fedwire because the Federal Reserve account of the beneficiary's bank is credited and final payment is made to that bank when the payment order is received.

Subsection (b)(2) would also apply to cases in which the beneficiary's bank mistakenly pays a person who is not the beneficiary of the payment order issued to the beneficiary's bank. For example, suppose the payment order provides for immediate payment to Account #12345. The beneficiary's bank erroneously credits Account #12346 and notifies the holder of that account of the credit. No acceptance occurs in this case under subsection (b)(1) because the beneficiary of the order has not been paid or notified. The holder of Account #12345 is the beneficiary of the order issued to the beneficiary's bank. But acceptance will normally occur if the beneficiary's bank takes no other action, because the bank will normally receive settlement with respect to the payment order. At that time the bank has accepted because the sender paid its payment order. The bank is liable to pay the holder of Account #12345. The bank has paid the holder of Account #12346 by mistake, and has a right to recover the payment if the credit is withdrawn, to the extent provided in the law governing mistake and restitution.

7. Subsection (b)(3) covers cases of inaction by the beneficiary's bank. It applies whether or not the sender is a bank and covers a case in which the

sender and the beneficiary both have accounts with the receiving bank and payment will be made by debiting the account of the sender and crediting the account of the beneficiary. Subsection (b)(3) is similar to subsection (b)(2) in that it bases acceptance by the beneficiary's bank on payment by the sender. Payment by the sender is effected by a debit to the sender's account if the account balance is sufficient to cover the amount of the order. On the payment date (Section 4A-401) of the order the beneficiary's bank will normally credit the beneficiary's account and notify the beneficiary of receipt of the order if it is satisfied that the sender's account balance covers the order or is willing to give credit to the sender. In some cases, however, the bank may not be willing to give credit to the sender and it may not be possible for the bank to determine until the end of the day on the payment date whether there are sufficient good funds in the sender's account. There may be various transactions during the day involving funds going into and out of the account. Some of these transactions may occur late in the day or after the close of the banking day. To accommodate this situation, subsection (b)(3) provides that the status of the account is determined at the opening of the next funds transfer business day of the beneficiary's bank after the payment date of the order. If the sender's account balance is sufficient to cover the order, the beneficiary's bank has a source of payment and the result in almost all cases is that the bank accepts the order at that time if it did not previously accept under subsection (b)(1). In rare cases, a bank may want to avoid acceptance under subsection (b)(3) by rejecting the order as discussed in Comment 8.

8. Section 4A-209 is based on a general principle that a receiving bank is not obliged to accept a payment order unless it has agreed or is bound by a funds transfer system rule to do so. Thus, provision is made to allow the receiving bank to prevent acceptance of the order. This principle is consistently followed if the receiving bank is not the beneficiary's bank. If the receiving bank is not the beneficiary's bank, acceptance is in the control of the receiving bank because it occurs only if the order is executed. But in the case of the beneficiary's bank acceptance can occur by passive receipt of payment under subsection (b)(2) or (3). In the case of a payment made by Fedwire acceptance cannot be prevented. In other cases the beneficiary's bank can prevent acceptance by giving notice of rejection to the sender before payment occurs under Section 4A-403(a)(1) or (2). A minor

exception to the ability of the beneficiary's bank to reject is stated in Section 4A-502(c)(3).

Under subsection (b)(3) acceptance occurs at the opening of the next funds transfer business day of the beneficiary's bank following the payment date unless the bank rejected the order before that time or it rejects within one hour after that time. In some cases the sender and the beneficiary's bank may not be in the same time zone or the beginning of the business day of the sender and the funds transfer business day of the beneficiary's bank may not coincide. For example, the sender may be located in California and the beneficiary's bank in New York. Since in most cases notice of rejection would be communicated electronically or by telephone, it might not be feasible for the bank to give notice before one hour after the opening of the funds transfer business day in New York because at that hour, the sender's business day may not have started in California. For that reason, there are alternative deadlines stated in subsection (b)(3). In the case stated, the bank acts in time if it gives notice within one hour after the opening of the business day of the sender. But if the notice of rejection is received by the sender after the payment date, the bank is obliged to pay interest to the sender if the sender's account does not bear interest. In that case the bank had the use of funds of the sender that the sender could reasonably assume would be used to pay the beneficiary. The rate of interest is stated in Section 4A-506. If the sender receives notice on the day after the payment date the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

9. Subsection (d) applies only to a payment order by the originator of a funds transfer to the originator's bank and it refers to the following situation. On April 1, Originator instructs Bank A to make a payment on April 15 to the account of Beneficiary in Bank B. By mistake, on April 1, Bank A executes Originator's payment order by issuing a payment order to Bank B instructing immediate payment to Beneficiary. Bank B credited Beneficiary's account and immediately released the funds to Beneficiary. Under subsection (d) no acceptance by Bank A occurred on April 1 when Originator's payment order was executed because acceptance cannot occur before the execution date which in this case would be April 15 or shortly before that date. Section 4A-301(b). Under Section 4A-402(c), Originator is

not obliged to pay Bank A until the order is accepted and that can't occur until the execution date. But Bank A is required to pay Bank B when Bank B accepted Bank A's order on April 1. Unless Originator and Beneficiary are the same person, in almost all cases Originator is paying a debt owed to Beneficiary and early payment does not injure Originator because Originator does not have to pay Bank A until the execution date. Section 4A-402(c). Bank A takes the interest loss. But suppose that on April 3, Originator concludes that no debt was owed to Beneficiary or that the debt was less than the amount of the payment order. Under Section 4A-211(b) Originator can cancel its payment order if Bank A has not accepted. If early execution of Originator's payment order is acceptance, Originator can suffer a loss because cancellation after acceptance is not possible without the consent of Bank A and Bank B. Section 4A-211(c). If Originator has to pay Bank A, Originator would be required to seek recovery of the money from Beneficiary. Subsection (d) prevents this result and puts the risk of loss on Bank A by providing that the early execution does not result in acceptance until the execution date. Since on April 3 Originator's order was not yet accepted, Originator can cancel it under Section 4A-211(b). The result is that Bank A is not entitled to payment from Originator but is obliged to pay Bank B. Bank A has paid Beneficiary by mistake. If Originator's payment order is cancelled, Bank A becomes the originator of an erroneous funds transfer to Beneficiary. Bank A has the burden of recovering payment from Beneficiary on the basis of a payment by mistake. If Beneficiary received the money in good faith in payment of a debt owed to Beneficiary by Originator, the law of mistake and restitution may allow Beneficiary to keep all or part of the money received. If Originator owed money to Beneficiary, Bank A has paid Originator's debt and, under the law of restitution, which applies pursuant to Section 1-103, Bank A is subrogated to Beneficiary's rights against Originator on the debt.

If Bank A is the Beneficiary's bank and Bank A credited Beneficiary's account and released the funds to Beneficiary on April 1, the analysis is similar. If Originator's order is cancelled, Bank A has paid Beneficiary by mistake. The right of Bank A to recover the payment from Beneficiary is similar to Bank A's rights in the preceding paragraph.

§ 28-4-618. Rejection of payment order. — (1) A payment order is rejected by the receiving bank by a notice of rejection transmitted to the sender orally, electronically, or in writing. A notice of rejection need not use any particular words and is sufficient if it indicates that the receiving bank is rejecting the order or will not execute or pay the order. Rejection is effective when the notice is given if transmission is by a means that is reasonable in the circumstances. If notice of rejection is given by a means that is not reasonable, rejection is effective when the notice is received. If an agreement of the sender and receiving bank establishes the means to be used to reject a payment order,

(a) any means complying with the agreement is reasonable, and

(b) any means not complying is not reasonable unless no significant delay in receipt of the notice resulted from the use of the noncomplying means.

(2) The provisions of this subsection apply if a receiving bank other than the beneficiary's bank fails to execute a payment order despite the existence on the execution date of a withdrawable credit balance in an authorized account of the sender sufficient to cover the order. If the sender does not receive notice of rejection of the order on the execution date and the authorized account of the sender does not bear interest, the bank is obliged to pay interest to the sender on the amount of the order for the number of days elapsing after the execution date to the earlier of the day the order is cancelled pursuant to section 28-4-619(4)[, Idaho Code,] or the day the sender receives notice or learns that the order was not executed, counting the final day of the period as an elapsed day. If the withdrawable credit balance during that period falls below the amount of the order, the amount of interest is reduced accordingly.

(3) If a receiving bank suspends payments, all unaccepted payment orders issued to it are deemed rejected at the time the bank suspends payments.

(4) Acceptance of a payment order precludes a later rejection of the order. Rejection of a payment order precludes a later acceptance of the order.

History.

I.C., § 28-4-618, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-210 in the uniform act.

The bracketed insertion in the second sentence in subsection (2) was added by the compiler to conform to the statutory citation style.

Official Comment

1. With respect to payment orders issued to a receiving bank other than the beneficiary's bank, notice of rejection is not necessary to prevent acceptance of the order. Acceptance can occur only if the receiving bank executes the order. Section 4A-209(a). But notice of rejection will routinely be given by such a bank in cases in which the bank cannot or is not willing to execute the order for some reason. There are many reasons why a bank doesn't execute an order. The payment order may not clearly instruct the receiving bank because of some ambiguity in the order or an internal inconsistency. In some cases, the receiving bank may not be able to carry out the instruction because of equipment failure, credit limitations on the receiving bank, or some other factor which makes proper execution of the order infeasible. In those cases notice of rejection is a means of informing the sender of the facts so that a corrected payment order can be transmitted or the sender can seek alternate means of completing the funds transfer. The other major reason for not executing an order is that the sender's account is insufficient to cover the order and the receiving bank is not willing to give credit to the sender. If the sender's account is sufficient to cover the order and the receiving bank chooses not to execute the order, notice of rejection is necessary to prevent liability to pay interest to the sender if the case falls within Section 4A-210(b) which is discussed in Comment 3.

2. A payment order to the beneficiary's bank can be accepted by inaction of the bank. Section 4A-209(b)(2) and (3). To prevent acceptance under those provisions it is necessary for the receiving bank to send notice of rejection before acceptance occurs. Subsection (a) of Section 4A-210 states

the rule that rejection is accomplished by giving notice of rejection. This incorporates the definitions in Section 1-201(26) [see § 28-1-202]. Rejection is effective when notice is given if it is given by a means that is reasonable in the circumstances. Otherwise it is effective when the notice is received. The question of when rejection is effective is important only in the relatively few cases under subsection (b)(2) and (3) in which a notice of rejection is necessary to prevent acceptance. The question of whether a particular means is reasonable depends on the facts in a particular case. In a very large percentage of cases the sender and the receiving bank will be in direct electronic contact with each other and in those cases a notice of rejection can be transmitted instantaneously. Since time is of the essence in a large proportion of funds transfers, some quick means of transmission would usually be required, but this is not always the case. The parties may specify by agreement the means by which communication between the parties is to be made.

3. Subsection (b) deals with cases in which a sender does not learn until after the execution date that the sender's order has not been executed. It applies only to cases in which the receiving bank was assured of payment because the sender's account was sufficient to cover the order. Normally, the receiving bank will accept the sender's order if it is assured of payment, but there may be some cases in which the bank chooses to reject. Unless the receiving bank had obligated itself by agreement to accept, the failure to accept is not wrongful. There is no duty of the receiving bank to accept the payment order unless it is obliged to accept by express agreement. Section 4A-212. But even if the bank has not acted wrongfully, the receiving bank had the use of the sender's money that the sender could reasonably assume was to be the source of payment of the funds transfer. Until the sender learns that the order was not accepted the sender is denied the use of that money. Subsection (b) obliges the receiving bank to pay interest to the sender as restitution unless the sender receives notice of rejection on the execution date. The time of receipt of notice is determined pursuant to § 1-201(27). The rate of interest is stated in Section 4A-506. If the sender receives notice on the day after the execution date, the sender is entitled to one day's interest. If receipt of notice is delayed for more than one day, the sender is entitled to interest for each additional day of delay.

4. Subsection (d) treats acceptance and rejection as mutually exclusive. If a payment order has been accepted, rejection of that order becomes impossible. If a payment order has been rejected it cannot be accepted later by the receiving bank. Once notice of rejection has been given, the sender may have acted on the notice by making the payment through other channels. If the receiving bank wants to act on a payment order that it has rejected it has to obtain the consent of the sender. In that case the consent of the sender would amount to the giving of a second payment order that substitutes for the rejected first order. If the receiving bank suspends payments (Section 4-104(1)(k)), subsection (c) provides that unaccepted payment orders are deemed rejected at the time suspension of payments occurs. This prevents acceptance by passage of time under Section 4A-209(b)(3).

§ 28-4-619. Cancellation and amendment of payment order. — (1) A communication of the sender of a payment order cancelling or amending the order may be transmitted to the receiving bank orally, electronically, or in writing. If a security procedure is in effect between the sender and the receiving bank, the communication is not effective to cancel or amend the order unless the communication is verified pursuant to the security procedure or the bank agrees to the cancellation or amendment.

(2) Subject to subsection (1) of this section, a communication by the sender cancelling or amending a payment order is effective to cancel or amend the order if notice of the communication is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order.

(3) After a payment order has been accepted, cancellation or amendment of the order is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation or amendment without agreement of the bank.

(a) With respect to a payment order accepted by a receiving bank other than the beneficiary's bank, cancellation or amendment is not effective unless a conforming cancellation or amendment of the payment order issued by the receiving bank is also made.

(b) With respect to a payment order accepted by the beneficiary's bank, cancellation or amendment is not effective unless the order was issued in execution of an unauthorized payment order, or because of a mistake by a sender in the funds transfer which resulted in the issuance of a payment order (i) that is a duplicate of a payment order previously issued by the sender, (ii) that orders payment to a beneficiary not entitled to receive payment from the originator, or (iii) that orders payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. If the payment order is cancelled or amended, the beneficiary's bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

(4) An unaccepted payment order is cancelled by operation of law at the close of the fifth funds-transfer business day of the receiving bank after the execution date or payment date of the order.

(5) A cancelled payment order cannot be accepted. If an accepted payment order is cancelled, the acceptance is nullified and no person has any right or obligation based on the acceptance. Amendment of a payment order is deemed to be cancellation of the original order at the time of amendment and issue of a new payment order in the amended form at the same time.

(6) Unless otherwise provided in an agreement of the parties or in a funds-transfer system rule, if the receiving bank, after accepting a payment order, agrees to cancellation or amendment of the order by the sender or is bound by a funds-transfer system rule allowing cancellation or amendment without the bank's agreement, the sender, whether or not cancellation or amendment is effective, is liable to the bank for any loss and expenses, including reasonable attorney's fees, incurred by the bank as a result of the cancellation or amendment or attempted cancellation or amendment.

(7) A payment order is not revoked by the death or legal incapacity of the sender unless the receiving bank knows of the death or of an adjudication of incapacity by a court of competent jurisdiction and has reasonable opportunity to act before acceptance of the order.

(8) A funds-transfer system rule is not effective to the extent it conflicts with the provisions of subsection (3)(b) of this section.

History.

I.C., § 28-4-619, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-211 in the uniform act.

Official Comment

1. This section deals with cancellation and amendment of payment orders. It states the conditions under which cancellation or amendment is

both effective and rightful. There is no concept of wrongful cancellation or amendment of a payment order. If the conditions stated in this section are not met the attempted cancellation or amendment is not effective. If the stated conditions are met the cancellation or amendment is effective and rightful. The sender of a payment order may want to withdraw or change the order because the sender has had a change of mind about the transaction or because the payment order was erroneously issued or for any other reason. One common situation is that of multiple transmission of the same order. The sender that mistakenly transmits the same order twice wants to correct the mistake by cancelling the duplicate order. Or, a sender may have intended to order a payment of $1,000,000 but mistakenly issued an order to pay $10,000,000. In this case the sender might try to correct the mistake by cancelling the order and issuing another order in the proper amount. Or, the mistake could be corrected by amending the order to change it to the proper amount. Whether the error is corrected by amendment or cancellation and reissue the net result is the same. This result is stated in the last sentence of subsection (e).

2. Subsection (a) allows a cancellation or amendment of a payment order to be communicated to the receiving bank "orally, electronically, or in writing." The quoted phrase is consistent with the language of Section 4A-103(a) applicable to payment orders. Cancellations and amendments are normally subject to verification pursuant to security procedures to the same extent as payment orders. Subsection (a) recognizes this fact by providing that in cases in which there is a security procedure in effect between the sender and the receiving bank the bank is not bound by a communication cancelling or amending an order unless verification has been made. This is necessary to protect the bank because under subsection (b) a cancellation or amendment can be effective by unilateral action of the sender. Without verification the bank cannot be sure whether the communication was or was not effective to cancel or amend a previously verified payment order.

3. If the receiving bank has not yet accepted the order, there is no reason why the sender should not be able to cancel or amend the order unilaterally so long as the requirements of subsections (a) and (b) are met. If the receiving bank has accepted the order, it is possible to cancel or amend but only if the requirements of subsection (c) are met.

First consider the case of a receiving bank other than the beneficiary's bank. If the bank has not yet accepted the order, the sender can unilaterally cancel or amend. The communication amending or cancelling the payment order must be received in time to allow the bank to act on it before the bank issues its payment order in execution of the sender's order. The time that the sender's communication is received is governed by Section 4A-106. If a payment order does not specify a delayed payment date or execution date, the order will normally be executed shortly after receipt. Thus, as a practical matter, the sender will have very little time in which to instruct cancellation or amendment before acceptance. In addition, a receiving bank will normally have cut-off times for receipt of such communications, and the receiving bank is not obliged to act on communications received after the cut-off hour. Cancellation by the sender after execution of the order by the receiving bank requires the agreement of the bank unless a funds transfer rule otherwise provides. Subsection (c). Although execution of the sender's order by the receiving bank does not itself impose liability on the receiving bank (under Section 4A-402 no liability is incurred by the receiving bank to pay its order until it is accepted), it would commonly be the case that acceptance follows shortly after issuance. Thus, as a practical matter, a receiving bank that has executed a payment order will incur a liability to the next bank in the chain before it would be able to act on the cancellation request of its customer. It is unreasonable to impose on the receiving bank a risk of loss with respect to a cancellation request without the consent of the receiving bank.

The statute does not state how or when the agreement of the receiving bank must be obtained for cancellation after execution. The receiving bank's consent could be obtained at the time cancellation occurs or it could be based on a preexisting agreement. Or, a funds transfer system rule could provide that cancellation can be made unilaterally by the sender. By virtue of that rule any receiving bank covered by the rule is bound. Section 4A-501. If the receiving bank has already executed the sender's order, the bank would not consent to cancellation unless the bank to which the receiving bank has issued its payment order consents to cancellation of that order. It makes no sense to allow cancellation of a payment order unless all subsequent payment orders in the funds transfer that were issued because of the cancelled payment order are also cancelled. Under subsection (c)(1), if a receiving bank consents to cancellation of the payment order after it is

executed, the cancellation is not effective unless the receiving bank also cancels the payment order issued by the bank.

4. With respect to a payment order issued to the beneficiary's bank, acceptance is particularly important because it creates liability to pay the beneficiary, it defines when the originator pays its obligation to the beneficiary, and it defines when any obligation for which the payment is made is discharged. Since acceptance affects the rights of the originator and the beneficiary it is not appropriate to allow the beneficiary's bank to agree to cancellation or amendment except in unusual cases. Except as provided in subsection (c)(2), cancellation or amendment after acceptance by the beneficiary's bank is not possible unless all parties affected by the order agree. Under subsection (c)(2), cancellation or amendment is possible only in the four cases stated. The following examples illustrate subsection (c)(2):

> **Case #1.** Originator's Bank executed a payment order issued in the name of its customer as sender. The order was not authorized by the customer and was fraudulently issued. Beneficiary's Bank accepted the payment order issued by Originator's Bank. Under subsection (c)(2) Originator's Bank can cancel the order if Beneficiary's Bank consents. It doesn't make any difference whether the payment order that Originator's Bank accepted was or was not enforceable against the customer under Section 4A-202(b). Verification under that provision is important in determining whether Originator's Bank or the customer has the risk of loss, but it has no relevance under Section 4A-211(c)(2). Whether or not verified, the payment order was not authorized by the customer. Cancellation of the payment order to Beneficiary's Bank causes the acceptance of Beneficiary's Bank to be nullified. Subsection (e). Beneficiary's Bank is entitled to recover payment from the beneficiary to the extent allowed by the law of mistake and restitution. In this kind of case the beneficiary is usually a party to the fraud who has no right to receive or retain payment of the order.

> **Case #2.** Originator owed Beneficiary $1,000,000 and ordered Bank A to pay that amount to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B, but by mistake issued a duplicate order as well. Bank B accepted both orders. Under subsection (c)(2)(i) cancellation of the duplicate order could be made by Bank A with the consent of Bank B. Beneficiary has no right to receive or retain

payment of the duplicate payment order if only $1,000,000 was owed by Originator to Beneficiary. If Originator owed $2,000,000 to Beneficiary, the law of restitution might allow Beneficiary to retain the $1,000,000 paid by Bank B on the duplicate order. In that case Bank B is entitled to reimbursement from Bank A under subsection (f).

Case #3. Originator owed $1,000,000 to X. Intending to pay X, Originator ordered Bank A to pay $1,000,000 to Y's account in Bank B. Bank A issued a complying payment order to Bank B which Bank B accepted by releasing the $1,000,000 to Y. Under subsection (c)(2)(ii) Bank A can cancel its payment order to Bank B with the consent of Bank B if Y was not entitled to receive payment from Originator. Originator can also cancel its order to Bank A with Bank A's consent. Subsection (c)(1). Bank B may recover the $1,000,000 from Y unless the law of mistake and restitution allows Y to retain some or all of the amount paid. If no debt was owed to Y, Bank B should have a right of recovery.

Case #4. Originator owed Beneficiary $10,000. By mistake Originator ordered Bank A to pay $1,000,000 to the account of Beneficiary in Bank B. Bank A issued a complying order to Bank B which accepted by notifying Beneficiary of its right to withdraw $1,000,000. Cancellation is permitted in this case under subsection (c)(2)(iii). If Bank B paid Beneficiary it is entitled to recover the payment except to the extent the law of mistake and restitution allows Beneficiary to retain payment. In this case Beneficiary might be entitled to retain $10,000, the amount of the debt owed to Beneficiary. If Beneficiary may retain $10,000, Bank B would be entitled to $10,000 from Bank A pursuant to subsection (f). In this case Originator also cancelled its order. Thus Bank A would be entitled to $10,000 from Originator pursuant to subsection (f).

5. Unless constrained by a funds transfer system rule, a receiving bank may agree to cancellation or amendment of the payment order under subsection (c) but is not required to do so regardless of the circumstances. If the receiving bank has incurred liability as a result of its acceptance of the sender's order, there are substantial risks in agreeing to cancellation or amendment. This is particularly true for a beneficiary's bank. Cancellation or amendment after acceptance by the beneficiary's bank can be made only

in the four cases stated and the beneficiary's bank may not have any way of knowing whether the requirements of subsection (c) have been met or whether it will be able to recover payment from the beneficiary that received payment. Even with indemnity the beneficiary's bank may be reluctant to alienate its customer, the beneficiary, by denying the customer the funds. Subsection (c) leaves the decision to the beneficiary's bank unless the consent of the beneficiary's bank is not required under a funds transfer system rule or other interbank agreement. If a receiving bank agrees to cancellation or amendment under subsection (c)(1) or (2), it is automatically entitled to indemnification from the sender under subsection (f). The indemnification provision recognizes that a sender has no right to cancel a payment order after it is accepted by the receiving bank. If the receiving bank agrees to cancellation, it is doing so as an accommodation to the sender and it should not incur a risk of loss in doing so.

6. Acceptance by the receiving bank of a payment order issued by the sender is comparable to acceptance of an offer under the law of contracts. Under that law the death or legal incapacity of an offeror terminates the offer even though the offeree has no notice of the death or incapacity. Restatement Second, Contracts § 48. Comment a. to that section states that the "rule seems to be a relic of the obsolete view that a contract requires a 'meeting of minds,' and it is out of harmony with the modern doctrine that a manifestation of assent is effective without regard to actual mental assent." Subsection (g), which reverses the Restatement rule in the case of a payment order, is similar to Section 4-405(1) which applies to checks. Subsection (g) does not address the effect of the bankruptcy of the sender of a payment order before the order is accepted, but the principle of subsection (g) has been recognized in *Bank of Marin v. England*, 385 U.S. 99 (1966). Although Bankruptcy Code Section 542(c) may not have been drafted with wire transfers in mind, its language can be read to allow the receiving bank to charge the sender's account for the amount of the payment order if the receiving bank executed it in ignorance of the bankruptcy.

7. Subsection (d) deals with stale payment orders. Payment orders normally are executed on the execution date or the day after. An order issued to the beneficiary's bank is normally accepted on the payment date or the day after. If a payment order is not accepted on its execution or payment date or shortly thereafter, it is probable that there was some problem with

the terms of the order or the sender did not have sufficient funds or credit to cover the amount of the order. Delayed acceptance of such an order is normally not contemplated, but the order may not have been cancelled by the sender. Subsection (d) provides for cancellation by operation of law to prevent an unexpected delayed acceptance.

8. A funds transfer system rule can govern rights and obligations between banks that are parties to payment orders transmitted over the system even if the rule conflicts with Article 4A. In some cases, however, a rule governing a transaction between two banks can affect a third party in an unacceptable way. Subsection (h) deals with such a case. A funds transfer system rule cannot allow cancellation of a payment order accepted by the beneficiary's bank if the rule conflicts with subsection (c)(2). Because rights of the beneficiary and the originator are directly affected by acceptance, subsection (c)(2) severely limits cancellation. These limitations cannot be altered by funds transfer system rule.

§ 28-4-620. Liability and duty of receiving bank regarding unaccepted payment order. — If a receiving bank fails to accept a payment order that it is obliged by express agreement to accept, the bank is liable for breach of the agreement to the extent provided in the agreement or in this part, but does not otherwise have any duty to accept a payment order or, before acceptance, to take any action, or refrain from taking action, with respect to the order except as provided in this part or by express agreement. Liability based on acceptance arises only when acceptance occurs as stated in section 28-4-617[, Idaho Code], and liability is limited to that provided in this part. A receiving bank is not the agent of the sender or beneficiary of the payment order it accepts, or of any other party to the funds transfer, and the bank owes no duty to any party to the funds transfer except as provided in this part or by express agreement.

History.

I.C., § 28-4-620, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-212 in the uniform act.

The bracketed insertion in the second sentence was added by the compiler to conform to the statutory citation style.

Official Comment With limited exceptions stated in this Article, the duties and obligations of receiving banks that carry out a funds transfer arise only as a result of acceptance of payment orders or of agreements made by receiving banks. Exceptions are stated in Section 4A-209(b)(3) and Section 4A-210(b). A receiving bank is not like a collecting bank under Article 4. No receiving bank, whether it be an originator's bank, an intermediary bank or a beneficiary's bank, is an agent for any other party in the funds transfer.

EXECUTION OF SENDER'S PAYMENT ORDER BY RECEIVING BANK

Idaho Code § 28-4-621

§ 28-4-621. Execution and execution date. — (1) A payment order is "executed" by the receiving bank when it issues a payment order intended to carry out the payment order received by the bank. A payment order received by the beneficiary's bank can be accepted but cannot be executed.

(2) "Execution date" of a payment order means the day on which the receiving bank may properly issue a payment order in execution of the sender's order. The execution date may be determined by instruction of the sender but cannot be earlier than the day the order is received and, unless otherwise determined, is the day the order is received. If the sender's instruction states a payment date, the execution date is the payment date or an earlier date on which execution is reasonably necessary to allow payment to the beneficiary on the payment date.

History.

I.C., § 28-4-621, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-301 in the uniform act.

Official Comment 1. The terms "executed," "execution" and "execution date" are used only with respect to a payment order to a receiving bank other than the beneficiary's bank. The beneficiary's bank can accept the payment order that it receives, but it does not execute the order. Execution refers to the act of the receiving bank in issuing a payment order "intended to carry out" the payment order that the bank received. A receiving bank has executed an order even if the order issued by the bank does not carry out the order received by the bank. For example, the bank may have erroneously issued an order to the

wrong beneficiary, or in the wrong amount or to the wrong beneficiary's bank. In each of these cases execution has occurred but the execution is erroneous. Erroneous execution is covered in Section 4A-303.

2. "Execution date" refers to the time a payment order should be executed rather than the day it is actually executed. Normally the sender will not specify an execution date, but most payment orders are meant to be executed immediately. Thus, the execution date is normally the day the order is received by the receiving bank. It is common for the sender to specify a "payment date" which is defined in Section 4A-401 as "the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank." Except for automated clearing house transfers, if a funds transfer is entirely within the United States and the payment is to be carried out electronically, the execution date is the payment date unless the order is received after the payment date. If the payment is to be carried out through an automated clearing house, execution may occur before the payment date. In an ACH transfer the beneficiary is usually paid one or two days after issue of the originator's payment order. The execution date is determined by the stated payment date and is a date before the payment date on which execution is reasonably necessary to allow payment on the payment date. A funds transfer system rule could also determine the execution date of orders received by the receiving bank if both the sender and the receiving bank are participants in the funds transfer system. The execution date can be determined by the payment order itself or by separate instructions of the sender or an agreement of the sender and the receiving bank. The second sentence of subsection (b) must be read in the light of Section 4A-106 which states that if a payment order is received after the cut-off time of the receiving bank it may be treated by the bank as received at the opening of the next funds transfer business day.

3. Execution on the execution date is timely, but the order can be executed before or after the execution date. Section 4A-209(d) and Section 4A-402(c) state the consequences of early execution and Section 4A-305(a) states the consequences of late execution.

§ 28-4-622. Obligations of receiving bank in execution of payment order. — (1) Except as provided in subsections (2) through (4) of this section, if the receiving bank accepts a payment order pursuant to section 28-4-617(1)[, Idaho Code], the bank has the following obligations in executing the order:

(a) The receiving bank is obliged to issue, on the execution date, a payment order complying with the sender's order and to follow the sender's instructions concerning (i) any intermediary bank or funds-transfer system to be used in carrying out the funds transfer, or (ii) the means by which payment orders are to be transmitted in the funds transfer. If the originator's bank issues a payment order to an intermediary bank, the originator's bank is obliged to instruct the intermediary bank according to the instruction of the originator. An intermediary bank in the funds transfer is similarly bound by an instruction given to it by the sender of the payment order it accepts.

(b) If the sender's instruction states that the funds transfer is to be carried out telephonically or by wire transfer or otherwise indicates that the funds transfer is to be carried out by the most expeditious means, the receiving bank is obliged to transmit its payment order by the most expeditious available means, and to instruct any intermediary bank accordingly. If a sender's instruction states a payment date, the receiving bank is obliged to transmit its payment order at a time and by means reasonably necessary to allow payment to the beneficiary on the payment date or as soon thereafter as is feasible.

(2) Unless otherwise instructed, a receiving bank executing a payment order may:

(a) use any funds-transfer system if use of that system is reasonable in the circumstances, and

(b) issue a payment order to the beneficiary's bank or to an intermediary bank through which a payment order conforming to the sender's order can expeditiously be issued to the beneficiary's bank if the receiving bank exercises ordinary care in the selection of the intermediary bank.

A receiving bank is not required to follow an instruction of the sender designating a funds-transfer system to be used in carrying out the funds transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would unduly delay completion of the funds transfer.

(3) Unless the provisions of subsection (1)(b) apply or the receiving bank is otherwise instructed, the bank may execute a payment order by transmitting its payment order by first class mail or by any means reasonable in the circumstances. If the receiving bank is instructed to execute the sender's order by transmitting its payment order by a particular means, the receiving bank may issue its payment order by the means stated or by any means as expeditious as the means stated.

(4) Unless instructed by the sender,

(a) the receiving bank may not obtain payment of its charges for services and expenses in connection with the execution of the sender's order by issuing a payment order in an amount equal to the amount of the sender's order less the amount of the charges, and

(b) may not instruct a subsequent receiving bank to obtain payment of its charges in the same manner.

History.

I.C., § 28-4-622, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-302 in the uniform act.

The bracketed insertion in the introductory paragraph in subsection (1) was added by the compiler to conform to the statutory citation style.

Official Comment

1. In the absence of agreement, the receiving bank is not obliged to execute an order of the sender. Section 4A-212. Section 4A-302 states the manner in which the receiving bank may execute the sender's order if

execution occurs. Subsection (a)(1) states the residual rule. The payment order issued by the receiving bank must comply with the sender's order and, unless some other rule is stated in the section, the receiving bank is obliged to follow any instruction of the sender concerning which funds transfer system is to be used, which intermediary banks are to be used, and what means of transmission is to be used. The instruction of the sender may be incorporated in the payment order itself or may be given separately. For example, there may be a master agreement between the sender and receiving bank containing instructions governing payment orders to be issued from time to time by the sender to the receiving bank. In most funds transfers, speed is a paramount consideration. A sender that wants assurance that the funds transfer will be expeditiously completed can specify the means to be used. The receiving bank can follow the instructions literally or it can use an equivalent means. For example, if the sender instructs the receiving bank to transmit by telex, the receiving bank could use telephone instead. Subsection (c). In most cases the sender will not specify a particular means but will use a general term such as "by wire" or "wire transfer" or "as soon as possible." These words signify that the sender wants a same-day transfer. In these cases the receiving bank is required to use a telephonic or electronic communication to transmit its order and is also required to instruct any intermediary bank to which it issues its order to transmit by similar means. Subsection (a)(2). In other cases, such as an automated clearing house transfer, a same-day transfer is not contemplated. Normally the sender's instruction or the context in which the payment order is received makes clear the type of funds transfer that is appropriate. If the sender states a payment date with respect to the payment order, the receiving bank is obliged to execute the order at a time and in a manner to meet the payment date if that is feasible. Subsection (a)(2). This provision would apply to many ACH transfers made to pay recurring debts of the sender. In other cases, involving relatively small amounts, time may not be an important factor and cost may be a more important element. Fast means, such as telephone or electronic transmission, are more expensive than slow means such as mailing. Subsection (c) states that in the absence of instructions the receiving bank is given discretion to decide. It may issue its payment order by first class mail or by any means reasonable in the circumstances. Section 4A-305 states the liability of a receiving bank for breach of the obligations stated in Section 4A-302.

2. Subsection (b) concerns the choice of intermediary banks to be used in completing the funds transfer, and the funds transfer system to be used. If the receiving bank is not instructed about the matter, it can issue an order directly to the beneficiary's bank or can issue an order to an intermediary bank. The receiving bank also has discretion concerning use of a funds transfer system. In some cases it may be reasonable to use either an automated clearing house system or a wire transfer system such as Fedwire or CHIPS. Normally, the receiving bank will follow the instruction of the sender in these matters, but in some cases it may be prudent for the bank not to follow instructions. The sender may have designated a funds transfer system to be used in carrying out the funds transfer, but it may not be feasible to use the designated system because of some impediment such as a computer breakdown which prevents prompt execution of the order. The receiving bank is permitted to use an alternate means of transmittal in a good faith effort to execute the order expeditiously. The same leeway is not given to the receiving bank if the sender designates an intermediary bank through which the funds transfer is to be routed. The sender's designation of that intermediary bank may mean that the beneficiary's bank is expecting to obtain a credit from that intermediary bank and may have relied on that anticipated credit. If the receiving bank uses another intermediary bank the expectations of the beneficiary's bank may not be realized. The receiving bank could choose to route the transfer to another intermediary bank and then to the designated intermediary bank if there was some reason such as a lack of a correspondent-bank relationship or a bilateral credit limitation, but the designated intermediary bank cannot be circumvented. To do so violates the sender's instructions.

3. The normal rule, under subsection (a)(1), is that the receiving bank, in executing a payment order, is required to issue a payment order that complies as to amount with that of the sender's order. In most cases the receiving bank issues an order equal to the amount of the sender's order and makes a separate charge for services and expenses in executing the sender's order. In some cases, particularly if it is an intermediary bank that is executing an order, charges are collected by deducting them from the amount of the payment order issued by the executing bank. If that is done, the amount of the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's payment order. For example, Originator, in order to pay an obligation of $1,000,000 owed to

Beneficiary, issues a payment order to Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank. Originator's Bank issues a payment order to Intermediary Bank for $1,000,000 and debits Originator's account for $1,000,010. The extra $10 is the fee of Originator's Bank. Intermediary Bank executes the payment order of Originator's Bank by issuing a payment order to Beneficiary's Bank for $999,990, but under § 4A-402(c) is entitled to receive $1,000,000 from Originator's Bank. The $10 difference is the fee of Intermediary Bank. Beneficiary's Bank credits Beneficiary's account for $999,990. When Beneficiary's Bank accepts the payment order of Intermediary Bank the result is a payment of $999,990 from Originator to Beneficiary. Section 4A-406(a). If that payment discharges the $1,000,000 debt, the effect is that Beneficiary has paid the charges of Intermediary Bank and Originator has paid the charges of Originator's Bank. Subsection (d) of Section 4A-302 allows Intermediary Bank to collect its charges by deducting them from the amount of the payment order, but only if instructed to do so by Originator's Bank. Originator's Bank is not authorized to give that instruction to Intermediary Bank unless Originator authorized the instruction. Thus, Originator can control how the charges of Originator's Bank and Intermediary Bank are to be paid. Subsection (d) does not apply to charges of Beneficiary's Bank to Beneficiary.

In the case discussed in the preceding paragraph the $10 charge is trivial in relation to the amount of the payment and it may not be important to Beneficiary how the charge is paid. But it may be very important if the $1,000,000 obligation represented the price of exercising a right such as an option favorable to Originator and unfavorable to Beneficiary. Beneficiary might well argue that it was entitled to receive $1,000,000. If the option was exercised shortly before its expiration date, the result could be loss of the option benefit because the required payment of $1,000,000 was not made before the option expired. Section 4A-406(c) allows Originator to preserve the option benefit. The amount received by Beneficiary is deemed to be $1,000,000 unless Beneficiary demands the $10 and Originator does not pay it.

§ 28-4-623. Erroneous execution of payment order. — (1) A receiving bank that:

(a) executes the payment order of the sender by issuing a payment order in an amount greater than the amount of the sender's order, or

(b) issues a payment order in execution of the sender's order and then issues a duplicate order, is entitled to payment of the amount of the sender's order under section 28-4-627(3)[, Idaho Code,] if the provisions of that subsection are otherwise satisfied. The bank is entitled to recover from the beneficiary of the erroneous order the excess payment received to the extent allowed by the law governing mistake and restitution.

(2) A receiving bank that executes the payment order of the sender by issuing a payment order in an amount less than the amount of the sender's order is entitled to payment of the amount of the sender's order under section 28-4-627(3)[, Idaho Code,] if:

(a) that subsection is otherwise satisfied, and

(b) the bank corrects its mistake by issuing an additional payment order for the benefit of the beneficiary of the sender's order.

If the error is not corrected, the issuer of the erroneous order is entitled to receive or retain payment from the sender of the order it accepted only to the extent of the amount of the erroneous order. The provisions of this subsection do not apply if the receiving bank executes the sender's payment order by issuing a payment order in an amount less than the amount of the sender's order for the purpose of obtaining payment of its charges for services and expenses pursuant to instruction of the sender.

(3) If a receiving bank executes the payment order of the sender by issuing a payment order to a beneficiary different from the beneficiary of the sender's order and the funds transfer is completed on the basis of that error, the sender of the payment order that was erroneously executed and all previous senders in the funds transfer are not obliged to pay the payment orders they issued. The issuer of the erroneous order is entitled to recover from the beneficiary of the order the payment received to the extent allowed by the law governing mistake and restitution.

History.

I.C., § 28-4-623, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-303 in the uniform act.

The bracketed insertions in paragraph (1)(b) and in the introductory paragraph in subsection (2) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Section 4A-303 states the effect of erroneous execution of a payment order by the receiving bank. Under Section 4A-402(c) the sender of a payment order is obliged to pay the amount of the order to the receiving bank if the bank executes the order, but the obligation to pay is excused if the beneficiary's bank does not accept a payment order instructing payment to the beneficiary of the sender's order. If erroneous execution of the sender's order causes the wrong beneficiary to be paid, the sender is not required to pay. If erroneous execution causes the wrong amount to be paid the sender is not obliged to pay the receiving bank an amount in excess of the amount of the sender's order. Section 4A-303 takes precedence over Section 4A-402(c) and states the liability of the sender and the rights of the receiving bank in various cases of erroneous execution.

2. Subsections (a) and (b) deal with cases in which the receiving bank executes by issuing a payment order in the wrong amount. If Originator ordered Originator's Bank to pay $1,000,000 to the account of Beneficiary in Beneficiary's Bank, but Originator's Bank erroneously instructed Beneficiary's Bank to pay $2,000,000 to Beneficiary's account, subsection (a) applies. If Beneficiary's Bank accepts the order of Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank, but Originator's Bank is entitled to receive only $1,000,000 from Originator. Originator's Bank is entitled to recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution. Originator's Bank would normally have a right to recover the

overpayment from Beneficiary, but in unusual cases the law of restitution might allow Beneficiary to keep all or part of the overpayment. For example, if Originator owed $2,000,000 to Beneficiary and Beneficiary received the extra $1,000,000 in good faith in discharge of the debt, Beneficiary may be allowed to keep it. In this case Originator's Bank has paid an obligation of Originator and under the law of restitution, which applies through Section 1-103, Originator's Bank would be subrogated to Beneficiary's rights against Originator on the obligation paid by Originator's Bank.

If Originator's Bank erroneously executed Originator's order by instructing Beneficiary's Bank to pay less than $1,000,000, subsection (b) applies. If Originator's Bank corrects its error by issuing another payment order to Beneficiary's Bank that results in payment of $1,000,000 to Beneficiary, Originator's Bank is entitled to payment of $1,000,000 from Originator. If the mistake is not corrected, Originator's Bank is entitled to payment from Originator only in the amount of the order issued by Originator's Bank.

3. Subsection (a) also applies to duplicate payment orders. Assume Originator's Bank properly executes Originator's $1,000,000 payment order and then by mistake issues a second $1,000,000 payment order in execution of Originator's order. If Beneficiary's Bank accepts both orders issued by Originator's Bank, Beneficiary's Bank is entitled to receive $2,000,000 from Originator's Bank but Originator's Bank is entitled to receive only $1,000,000 from Originator. The remedy of Originator's Bank is the same as that of a receiving bank that executes by issuing an order in an amount greater than the sender's order. It may recover the overpayment from Beneficiary to the extent allowed by the law governing mistake and restitution and in a proper case as stated in Comment 2 may have subrogation rights if it is not entitled to recover from Beneficiary.

4. Suppose Originator instructs Originator's Bank to pay $1,000,000 to Account #12345 in Beneficiary's Bank. Originator's Bank erroneously instructs Beneficiary's Bank to pay $1,000,000 to Account #12346 and Beneficiary's Bank accepted. Subsection (c) covers this case. Originator is not obliged to pay its payment order, but Originator's Bank is required to pay $1,000,000 to Beneficiary's Bank. The remedy of Originator's Bank is to recover $1,000,000 from the holder of Account #12346 that received

payment by mistake. Recovery based on the law of mistake and restitution is described in Comment 2.

§ 28-4-624. Duty of sender to report erroneously executed payment order. — If the sender of a payment order that is erroneously executed as stated in section 28-4-623[, Idaho Code,] receives notification from the receiving bank that the order was executed or that the sender's account was debited with respect to the order, the sender has a duty to exercise ordinary care to determine, on the basis of information available to the sender, that the order was erroneously executed and to notify the bank of the relevant facts within a reasonable time not exceeding ninety (90) days after the notification from the bank was received by the sender. If the sender fails to perform that duty, the bank is not obliged to pay interest on any amount refundable to the sender under section 28-4-627(4)[, Idaho Code,] for the period before the bank learns of the execution error. The bank is not entitled to any recovery from the sender on account of a failure by the sender to perform the duty stated in this section.

History.

I.C., § 28-4-624, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-304 in the uniform act.

The bracketed insertions in the first and second sentences were added by the compiler to conform to the statutory citation style.

Official Comment This section is identical in effect to Section 4A-204 which applies to unauthorized orders issued in the name of a customer of the receiving bank. The rationale is stated in Comment 2 to Section 4A-204.

§ 28-4-625. Liability for late or improper execution or failure to execute payment order. — (1) If a funds transfer is completed but execution of a payment order by the receiving bank in breach of the provisions of section 28-4-622[, Idaho Code,] results in delay in payment to the beneficiary, the bank is obliged to pay interest to either the originator or the beneficiary of the funds transfer for the period of delay caused by the improper execution. Except as provided in subsection (3) of this section, additional damages are not recoverable.

(2) If execution of a payment order by a receiving bank in breach of section 28-4-622[, Idaho Code,] results in:

(a) noncompletion of the funds transfer,

(b) failure to use an intermediary bank designated by the originator, or

(c) issuance of a payment order that does not comply with the terms of the payment order of the originator, the bank is liable to the originator for its expenses in the funds transfer and for incidental expenses and interest losses, to the extent not covered in subsection (1) of this section, resulting from the improper execution.

Except as provided in subsection (3) of this section, additional damages are not recoverable.

(3) In addition to the amounts payable under subsections (1) and (2) of this section, damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank.

(4) If a receiving bank fails to execute a payment order it was obliged by express agreement to execute, the receiving bank is liable to the sender for its expenses in the transaction and for incidental expenses and interest losses resulting from the failure to execute. Additional damages, including consequential damages, are recoverable to the extent provided in an express written agreement of the receiving bank, but are not otherwise recoverable.

(5) Reasonable attorney's fees are recoverable if demand for compensation under subsection (1) or (2) of this section is made and refused before an action is brought on the claim. If a claim is made for

breach of an agreement under subsection (4) of this section, and the agreement does not provide for damages, reasonable attorney's fees are recoverable if demand for compensation under subsection (4) of this section, is made and refused before an action is brought on the claim.

(6) Except as stated in this section, the liability of a receiving bank under subsections (1) and (2) of this section, may not be varied by agreement.

History.

I.C., § 28-4-625, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-305 in the uniform act.

The bracketed insertions in subsection (1) and in the introductory paragraph in subsection (2) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Subsection (a) covers cases of delay in completion of a funds transfer resulting from an execution by a receiving bank in breach of Section 4A-302(a). The receiving bank is obliged to pay interest on the amount of the order for the period of the delay. The rate of interest is stated in Section 4A-506. With respect to wire transfers (other than ACH transactions) within the United States, the expectation is that the funds transfer will be completed the same day. In those cases, the originator can reasonably expect that the originator's account will be debited on the same day as the beneficiary's account is credited. If the funds transfer is delayed, compensation can be paid either to the originator or to the beneficiary. The normal practice is to compensate the beneficiary's bank to allow that bank to compensate the beneficiary by back-valuing the payment by the number of days of delay. Thus, the beneficiary is in the same position that it would have been in if the funds transfer had been completed on the same day. Assume on Day 1, Originator's Bank issues its payment order to Intermediary Bank which is received on that day. Intermediary Bank does not execute that order until

Day 2 when it issues an order to Beneficiary's Bank which is accepted on that day. Intermediary Bank complies with subsection (a) by paying one day's interest to Beneficiary's Bank for the account of Beneficiary.

2. Subsection (b) applies to cases of breach of Section 4A-302 involving more than mere delay. In those cases the bank is liable for damages for improper execution but they are limited to compensation for interest losses and incidental expenses of the sender resulting from the breach, the expenses of the sender in the funds transfer and attorney's fees. This subsection reflects the judgment that imposition of consequential damages on a bank for commission of an error is not justified.

The leading common law case on the subject of consequential damages is *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982), in which Swiss Bank, an intermediary bank, failed to execute a payment order. Because the beneficiary did not receive timely payment the originator lost a valuable ship charter. The lower court awarded the originator $2.1 million for lost profits even though the amount of the payment order was only $27,000. The Seventh Circuit reversed, in part on the basis of the common law rule of *Hadley v. Baxendale* that consequential damages may not be awarded unless the defendant is put on notice of the special circumstances giving rise to them. Swiss Bank may have known that the originator was paying the shipowner for the hire of a vessel but did not know that a favorable charter would be lost if the payment was delayed. "Electronic payments are not so unusual as to automatically place a bank on notice of extraordinary consequences if such a transfer goes awry. Swiss Bank did not have enough information to infer that if it lost a $27,000 payment order it would face liability in excess of $2 million." 673 F.2d at 956.

If *Evra* means that consequential damages can be imposed if the culpable bank has notice of particular circumstances giving rise to the damages, it does not provide an acceptable solution to the problem of bank liability for consequential damages. In the typical case transmission of the payment order is made electronically. Personnel of the receiving bank that process payment orders are not the appropriate people to evaluate the risk of liability for consequential damages in relation to the price charged for the wire transfer service. Even if notice is received by higher level management personnel who could make an appropriate decision whether the risk is justified by the price, liability based on notice would require evaluation of

payment orders on an individual basis. This kind of evaluation is inconsistent with the high-speed, low-price, mechanical nature of the processing system that characterizes wire transfers. Moreover, in *Evra* the culpable bank was an intermediary bank with which the originator did not deal. Notice to the originator's bank would not bind the intermediary bank, and it seems impractical for the originator's bank to convey notice of this kind to intermediary banks in the funds transfer. The success of the wholesale wire transfer industry has largely been based on its ability to effect payment at low cost and great speed. Both of these essential aspects of the modern wire transfer system would be adversely affected by a rule that imposed on banks liability for consequential damages. A banking industry amicus brief in *Evra* stated: "Whether banks can continue to make EFT services available on a widespread basis, by charging reasonable rates, depends on whether they can do so without incurring unlimited consequential risks. Certainly, no bank would handle for $3.25 a transaction entailing potential liability in the millions of dollars."

As the court in *Evra* also noted, the originator of the funds transfer is in the best position to evaluate the risk that a funds transfer will not be made on time and to manage that risk by issuing a payment order in time to allow monitoring of the transaction. The originator, by asking the beneficiary, can quickly determine if the funds transfer has been completed. If the originator has sent the payment order at a time that allows a reasonable margin for correcting error, no loss is likely to result if the transaction is monitored. The other published cases on this issue reach the *Evra* result. *Central Coordinates, Inc. v. Morgan Guaranty Trust Co.*, 40 U.C.C. Rep. Serv. 1340 (N.Y. Sup. Ct. 1985), and *Gatoil (U.S.A.), Inc. v. Forest Hill State Bank*, 1 U.C.C. Rep. Serv. 2d 171 (D. Md. 1986).

Subsection (c) allows the measure of damages in subsection (b) to be increased by an express written agreement of the receiving bank. An originator's bank might be willing to assume additional responsibilities and incur additional liability in exchange for a higher fee.

3. Subsection (d) governs cases in which a receiving bank has obligated itself by express agreement to accept payment orders of a sender. In the absence of such an agreement there is no obligation by a receiving bank to accept a payment order. Section 4A-212. The measure of damages for breach of an agreement to accept a payment order is the same as that stated

in subsection (b). As in the case of subsection (b), additional damages, including consequential damages, may be recovered to the extent stated in an express written agreement of the receiving bank.

4. Reasonable attorney's fees are recoverable only in cases in which damages are limited to statutory damages stated in subsections (a), (b) and (d). If additional damages are recoverable because provided for by an express written agreement, attorney's fees are not recoverable. The rationale is that there is no need for statutory attorney's fees in the latter case, because the parties have agreed to a measure of damages which may or may not provide for attorney's fees.

5. The effect of subsection (f) is to prevent reduction of a receiving bank's liability under Section 4A-305.

PAYMENT

§ 28-4-626. Payment date. — "Payment date" of a payment order means the day on which the amount of the order is payable to the beneficiary by the beneficiary's bank. The payment date may be determined by instruction of the sender but cannot be earlier than the day the order is received by the beneficiary's bank and, unless otherwise determined, is the day the order is received by the beneficiary's bank.

History.

I.C., § 28-4-626, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-401 in the uniform act.

Official Comment "Payment date" refers to the day the beneficiary's bank is to pay the beneficiary. The payment date may be expressed in various ways so long as it indicates the day the beneficiary is to receive payment. For example, in ACH transfers the payment date is the equivalent of "settlement date" or "effective date." Payment date applies to the payment order issued to the beneficiary's bank, but a payment order issued to a receiving bank other than the beneficiary's bank may also state a date for payment to the beneficiary. In the latter case, the statement of a payment date is to instruct the receiving bank concerning time of execution of the sender's order. Section 4A-301(b).

§ 28-4-627. Obligation of sender to pay receiving bank. — (1) The provisions of this section are subject to the provisions of sections 28-4-613 and 28-4-615[, Idaho Code].

(2) With respect to a payment order issued to the beneficiary's bank, acceptance of the order by the bank obliges the sender to pay the bank the amount of the order, but payment is not due until the payment date of the order.

(3) The provisions of this subsection are subject to the provisions of subsection (5) of this section and to section 28-4-623[, Idaho Code]. With respect to a payment order issued to a receiving bank other than the beneficiary's bank, acceptance of the order by the receiving bank obliges the sender to pay the bank the amount of the sender's order. Payment by the sender is not due until the execution date of the sender's order. The obligation of that sender to pay its payment order is excused if the funds transfer is not completed by acceptance by the beneficiary's bank of a payment order instructing payment to the beneficiary of that sender's payment order.

(4) If the sender of a payment order pays the order and was not obliged to pay all or part of the amount paid, the bank receiving payment is obliged to refund payment to the extent the sender was not obliged to pay. Except as provided in sections 28-4-612 and 28-4-624[, Idaho Code], interest is payable on the refundable amount from the date of payment.

(5) If a funds transfer is not completed as stated in subsection (3) of this section and an intermediary bank is obliged to refund payment as stated in subsection (4) of this section but is unable to do so because it is not permitted by applicable law or because the bank suspends payments, a sender in the funds transfer that executed a payment order in compliance with an instruction, as stated in section 28-4-622(1)(a)[, Idaho Code], to route the funds transfer through that intermediary bank is entitled to receive or retain payment from the sender of the payment order that it accepted. The first sender in the funds transfer that issued an instruction requiring routing through that intermediary bank is subrogated to the right of the bank

that paid the intermediary bank to refund as stated in subsection (4) of this section.

(6) The right of the sender of a payment order to be excused from the obligation to pay the order as stated in subsection (3) of this section or to receive refund under subsection (4) may not be varied by agreement.

History.

I.C., § 28-4-627, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-402 in the uniform act.

The bracketed insertions in subsections (1), (3), (4), and (5) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Subsection (b) states that the sender of a payment order to the beneficiary's bank must pay the order when the beneficiary's bank accepts the order. At that point the beneficiary's bank is obliged to pay the beneficiary. Section 4A-404(a). The last clause of subsection (b) covers a case of premature acceptance by the beneficiary's bank. In some funds transfers, notably automated clearing house transfers, a beneficiary's bank may receive a payment order with a payment date after the day the order is received. The beneficiary's bank might accept the order before the payment date by notifying the beneficiary of receipt of the order. Although the acceptance obliges the beneficiary's bank to pay the beneficiary, payment is not due until the payment date. The last clause of subsection (b) is consistent with that result. The beneficiary's bank is also not entitled to payment from the sender until the payment date.

2. Assume that Originator instructs Bank A to order immediate payment to the account of Beneficiary in Bank B. Execution of Originator's payment order by Bank A is acceptance under Section 4A-209(a). Under the second sentence of Section 4A-402(c) the acceptance creates an obligation of Originator to pay Bank A the amount of the order. The last clause of that

sentence deals with attempted funds transfers that are not completed. In that event the obligation of the sender to pay its payment order is excused. Originator makes payment to Beneficiary when Bank B, the beneficiary's bank, accepts a payment order for the benefit of Beneficiary. Section 4A-406(a). If that acceptance by Bank B does not occur, the funds transfer has miscarried because Originator has not paid Beneficiary. Originator doesn't have to pay its payment order, and if it has already paid it is entitled to refund of the payment with interest. The rate of interest is stated in Section 4A-506. This "money-back guarantee" is an important protection of Originator. Originator is assured that it will not lose its money if something goes wrong in the transfer. For example, risk of loss resulting from payment to the wrong beneficiary is borne by some bank, not by Originator. The most likely reason for noncompletion is a failure to execute or an erroneous execution of a payment order by Bank A or an intermediary bank. Bank A may have issued its payment order to the wrong bank or it may have identified the wrong beneficiary in its order. The money-back guarantee is particularly important to Originator if noncompletion of the funds transfer is due to the fault of an intermediary bank rather than Bank A. In that case Bank A must refund payment to Originator, and Bank A has the burden of obtaining refund from the intermediary bank that it paid.

Subsection (c) can result in loss if an intermediary bank suspends payments. Suppose Originator instructs Bank A to pay to Beneficiary's account in Bank B and to use Bank C as an intermediary bank. Bank A executes Originator's order by issuing a payment order to Bank C. Bank A pays Bank C. Bank C fails to execute the order of Bank A and suspends payments. Under subsections (c) and (d), Originator is not obliged to pay Bank A and is entitled to refund from Bank A of any payment that it may have made. Bank A is entitled to a refund from Bank C, but Bank C is insolvent. Subsection (e) deals with this case. Bank A was required to issue its payment order to Bank C because Bank C was designated as an intermediary bank by Originator. Section 4A-302(a)(1). In this case Originator takes the risk of insolvency of Bank C. Under subsection (e), Bank A is entitled to payment from Originator and Originator is subrogated to the right of Bank A under subsection (d) to refund of payment from Bank C.

3. A payment order is not like a negotiable instrument on which the drawer or maker has liability. Acceptance of the order by the receiving bank creates an obligation of the sender to pay the receiving bank the amount of the order. That is the extent of the sender's liability to the receiving bank and no other person has any rights against the sender with respect to the sender's order.

§ 28-4-628. Payment by sender to receiving bank. — (1) Payment of the sender's obligation under section 28-4-627[, Idaho Code,] to pay the receiving bank occurs as follows:

(a) If the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through a Federal Reserve bank or through a funds-transfer system.

(b) If the sender is a bank and the sender (i) credited an account of the receiving bank with the sender, or (ii) caused an account of the receiving bank in another bank to be credited, payment occurs when the credit is withdrawn or, if not withdrawn, at midnight of the day on which the credit is withdrawable and the receiving bank learns of that fact.

(c) If the receiving bank debits an account of the sender with the receiving bank, payment occurs when the debit is made to the extent the debit is covered by a withdrawable credit balance in the account.

(2) If the sender and receiving bank are members of a funds-transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against the sender's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds-transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds-transfer system may be satisfied, to the extent permitted by the rules of the system, by setting off and applying against that balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance is determined after the right of setoff stated in the second sentence of this subsection has been exercised.

(3) If two (2) banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under

section 28-4-627[, Idaho Code,] will be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one (1) bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff, each bank has made payment to the other.

(4) In a case not covered by subsection (1) of this section, the time when payment of the sender's obligation under section 28-4-627(2) or (3)[, Idaho Code,] occurs is governed by applicable principles of law that determine when an obligation is satisfied.

History.

I.C., § 28-4-628, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-403 in the uniform act.

The bracketed insertions in the introductory paragraph in subsection (1) and in subsections (3) and (4) were added by the compiler to conform to the statutory citation style.

Official Comment

1. This section defines when a sender pays the obligation stated in Section 4A-402. If a group of two or more banks engage in funds transfers with each other, the participating banks will sometimes be senders and sometimes receiving banks. With respect to payment orders other than Fedwires, the amounts of the various payment orders may be credited and debited to accounts of one bank with another or to a clearing house account of each bank and amounts owed and amounts due are netted. Settlement is made through a Federal Reserve Bank by charges to the Federal Reserve accounts of the net debtor banks and credits to the Federal Reserve accounts of the net creditor banks. In the case of Fedwires the sender's obligation is settled by a debit to the Federal Reserve account of the sender and a credit to the Federal Reserve account of the receiving bank at the time the receiving bank receives the payment order. Both of these cases are covered

by subsection (a)(1). When the Federal Reserve settlement becomes final the obligation of the sender under Section 4A-402 is paid.

2. In some cases a bank does not settle an obligation owed to another bank through a Federal Reserve Bank. This is the case if one of the banks is a foreign bank without access to the Federal Reserve payment system. In this kind of case, payment is usually made by credits or debits to accounts of the two banks with each other or to accounts of the two banks in a third bank. Suppose Bank B has an account in Bank A. Bank A advises Bank B that its account in Bank A has been credited $1,000,000 and that the credit is immediately withdrawable. Bank A also instructs Bank B to pay $1,000,000 to the account of Beneficiary in Bank B. This case is covered by subsection (a)(2). Bank B may want to immediately withdraw this credit. For example, it might do so by instructing Bank A to debit the account and pay some third party. Payment by Bank A to Bank B of Bank A's payment order occurs when the withdrawal is made. Suppose Bank B does not withdraw the credit. Since Bank B is the beneficiary's bank, one of the effects of receipt of payment by Bank B is that acceptance of Bank A's payment order automatically occurs at the time of payment. Section 4A-209(b)(2). Acceptance means that Bank B is obliged to pay $1,000,000 to Beneficiary. Section 4A-404(a). Subsection (a)(2) of Section 4A-403 states that payment does not occur until midnight if the credit is not withdrawn. This allows Bank B an opportunity to reject the order if it does not have time to withdraw the credit to its account and it is not willing to incur the liability to Beneficiary before it has use of the funds represented by the credit.

3. Subsection (a)(3) applies to a case in which the sender (bank or nonbank) has a funded account in the receiving bank. If Sender has an account in Bank and issues a payment order to Bank, Bank can obtain payment from Sender by debiting the account of Sender, which pays its Section 4A-402 obligation to Bank when the debit is made.

4. Subsection (b) deals with multilateral settlements made through a funds transfer system and is based on the CHIPS settlement system. In a funds transfer system such as CHIPS, which allows the various banks that transmit payment orders over the system to settle obligations at the end of each day, settlement is not based on individual payment orders. Each bank using the system engages in funds transfers with many other banks using

the system. Settlement for any participant is based on the net credit or debit position of that participant with all other banks using the system. Subsection (b) is designed to make clear that the obligations of any sender are paid when the net position of that sender is settled in accordance with the rules of the funds transfer system. This provision is intended to invalidate any argument, based on common-law principles, that multilateral netting is not valid because mutuality of obligation is not present. Subsection (b) dispenses with any mutuality of obligation requirements. Subsection (c) applies to cases in which two banks send payment orders to each other during the day and settle with each other at the end of the day or at the end of some other period. It is similar to subsection (b) in that it recognizes that a sender's obligation to pay a payment order is satisfied by a setoff. The obligations of each bank as sender to the other as receiving bank are obligations of the bank itself and not as representative of customers. These two sections are important in the case of insolvency of a bank. They make clear that liability under Section 4A-402 is based on the net position of the insolvent bank after setoff.

5. Subsection (d) relates to the uncommon case in which the sender doesn't have an account relationship with the receiving bank and doesn't settle through a Federal Reserve Bank. An example would be a customer that pays over the counter for a payment order that the customer issues to the receiving bank. Payment would normally be by cash, check or bank obligation. When payment occurs is determined by law outside Article 4A.

§ 28-4-629. Obligation of beneficiary's bank to pay and give notice to beneficiary. — (1) Subject to sections 28-4-619(5), 28-4-630(4) and (5) [, Idaho Code], if a beneficiary's bank accepts a payment order, the bank is obliged to pay the amount of the order to the beneficiary of the order. Payment is due on the payment date of the order, but if acceptance occurs on the payment date after the close of the funds-transfer business day of the bank, payment is due on the next funds-transfer business day. If the bank refuses to pay after demand by the beneficiary and receipt of notice of particular circumstances that will give rise to consequential damages as a result of nonpayment, the beneficiary may recover damages resulting from the refusal to pay to the extent the bank had notice of the damages, unless the bank proves that it did not pay because of a reasonable doubt concerning the right of the beneficiary to payment.

(2) If a payment order accepted by the beneficiary's bank instructs payment to an account of the beneficiary, the bank is obliged to notify the beneficiary of receipt of the order before midnight of the next funds-transfer business day following the payment date. If the payment order does not instruct payment to an account of the beneficiary, the bank is required to notify the beneficiary only if notice is required by the order. Notice may be given by first class mail or any other means reasonable in the circumstances. If the bank fails to give the required notice, the bank is obliged to pay interest to the beneficiary on the amount of the payment order from the day notice should have been given until the day the beneficiary learned of receipt of the payment order by the bank. No other damages are recoverable. Reasonable attorney's fees are also recoverable if demand for interest is made and refused before an action is brought on the claim.

(3) The right of a beneficiary to receive payment and damages as stated in subsection (1) of this section may not be varied by agreement or a funds-transfer system rule. The right of a beneficiary to be notified as stated in subsection (2) of this section may be varied by agreement of the beneficiary or by a funds-transfer system rule if the beneficiary is notified of the rule before initiation of the funds transfer.

History.

I.C., § 28-4-629, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-404 in the uniform act.

The bracketed insertion in subsection (1) was added by the compiler to conform to the statutory citation style.

Official Comment

1. The first sentence of subsection (a) states the time when the obligation of the beneficiary's bank arises. The second and third sentences state when the beneficiary's bank must make funds available to the beneficiary. They also state the measure of damages for failure, after demand, to comply. Since the Expedited Funds Availability Act, 12 U.S.C. 4001 et seq., also governs funds availability in a funds transfer, the second and third sentences of subsection (a) may be subject to preemption by that Act.

2. Subsection (a) provides that the beneficiary of an accepted payment order may recover consequential damages if the beneficiary's bank refuses to pay the order after demand by the beneficiary if the bank at that time had notice of the particular circumstances giving rise to the damages. Such damages are recoverable only to the extent the bank had "notice of the damages." The quoted phrase requires that the bank have notice of the general type or nature of the damages that will be suffered as a result of the refusal to pay and their general magnitude. There is no requirement that the bank have notice of the exact or even the approximate amount of the damages, but if the amount of damages is extraordinary the bank is entitled to notice of that fact. For example, in *Evra Corp. v. Swiss Bank Corp.*, 673 F.2d 951 (7th Cir. 1982), failure to complete a funds transfer of only $27,000 required to retain rights to a very favorable ship charter resulted in a claim for more than $2,000,000 of consequential damages. Since it is not reasonably foreseeable that a failure to make a relatively small payment will result in damages of this magnitude, notice is not sufficient if the beneficiary's bank has notice only that the $27,000 is necessary to retain

rights on a ship charter. The bank is entitled to notice that an exceptional amount of damages will result as well. For example, there would be adequate notice if the bank had been made aware that damages of $1,000,000 or more might result.

3. Under the last clause of subsection (a) the beneficiary's bank is not liable for damages if its refusal to pay was "because of a reasonable doubt concerning the right of the beneficiary to payment." Normally there will not be any question about the right of the beneficiary to receive payment. Normally, the bank should be able to determine whether it has accepted the payment order and, if it has been accepted, the first sentence of subsection (a) states that the bank is obliged to pay. There may be uncommon cases, however, in which there is doubt whether acceptance occurred. For example, if acceptance is based on receipt of payment by the beneficiary's bank under Section 4A-403 (a)(1) or (2), there may be cases in which the bank is not certain that payment has been received. There may also be cases in which there is doubt about whether the person demanding payment is the person identified in the payment order as beneficiary of the order.

The last clause of subsection (a) does not apply to cases in which a funds transfer is being used to pay an obligation and a dispute arises between the originator and the beneficiary concerning whether the obligation is in fact owed. For example, the originator may try to prevent payment to the beneficiary by the beneficiary's bank by alleging that the beneficiary is not entitled to payment because of fraud against the originator or a breach of contract relating to the obligation. The fraud or breach of contract claim of the originator may be grounds for recovery by the originator from the beneficiary after the beneficiary is paid, but it does not affect the obligation of the beneficiary's bank to pay the beneficiary. Unless the payment order has been cancelled pursuant to Section 4A-211(c), there is no excuse for refusing to pay the beneficiary and, in a proper case, the refusal may result in consequential damages. Except in the case of a book transfer, in which the beneficiary's bank is also the originator's bank, the originator of a funds transfer cannot cancel a payment order to the beneficiary's bank, with or without the consent of that bank, because the originator is not the sender of that order. Thus, the beneficiary's bank may safely ignore any instruction by the originator to withhold payment to the beneficiary.

4. Subsection (b) states the duty of the beneficiary's bank to notify the beneficiary of receipt of the order. If acceptance occurs under Section 4A-209(b)(1) the beneficiary is normally notified. Thus, subsection (b) applies primarily to cases in which acceptance occurs under Section 4A-209(b)(2) or (3). Notice under subsection (b) is not required if the person entitled to the notice agrees or a funds transfer system rule provides that notice is not required and the beneficiary is given notice of the rule. In ACH transactions the normal practice is not to give notice to the beneficiary unless notice is requested by the beneficiary. This practice can be continued by adoption of a funds transfer system rule. Subsection (a) is not subject to variation by agreement or by a funds transfer system rule.

§ 28-4-630. Payment by beneficiary's bank to beneficiary. — (1) If the beneficiary's bank credits an account of the beneficiary of a payment order, payment of the bank's obligation under section 28-4-629(1)[, Idaho Code,] occurs when and to the extent:

(a) the beneficiary is notified of the right to withdraw the credit,

(b) the bank lawfully applies the credit to a debt of the beneficiary, or

(c) funds with respect to the order are otherwise made available to the beneficiary by the bank.

(2) If the beneficiary's bank does not credit an account of the beneficiary of a payment order, the time when payment of the bank's obligation under section 28-4-629(1)[, Idaho Code,] occurs is governed by principles of law that determine when an obligation is satisfied.

(3) Except as stated in subsections (4) and (5) of this section, if the beneficiary's bank pays the beneficiary of a payment order under a condition to payment or agreement of the beneficiary giving the bank the right to recover payment from the beneficiary if the bank does not receive payment of the order, the condition to payment or agreement is not enforceable.

(4) A funds-transfer system rule may provide that payments made to beneficiaries of funds transfers made through the system are provisional until receipt of payment by the beneficiary's bank of the payment order it accepted. A beneficiary's bank that makes a payment that is provisional under the rule is entitled to refund from the beneficiary if:

(a) the rule requires that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated,

(b) the beneficiary, the beneficiary's bank and the originator's bank agreed to be bound by the rule, and

(c) the beneficiary's bank did not receive payment of the payment order that it accepted.

If the beneficiary is obliged to refund payment to the beneficiary's bank, acceptance of the payment order by the beneficiary's bank is nullified and no payment by the originator of the funds transfer to the beneficiary occurs under section 28-4-631[, Idaho Code].

(5) The provisions of this subsection apply to a funds transfer that includes a payment order transmitted over a funds-transfer system that:

(a) nets obligations multilaterally among participants, and

(b) has in effect a loss-sharing agreement among participants for the purpose of providing funds necessary to complete settlement of the obligations of one (1) or more participants that do not meet their settlement obligations. If the beneficiary's bank in the funds transfer accepts a payment order and the system fails to complete settlement pursuant to its rules with respect to any payment order in the funds transfer,

(i) the acceptance by the beneficiary's bank is nullified and no person has any right or obligation based on the acceptance,

(ii) the beneficiary's bank is entitled to recover payment from the beneficiary,

(iii) no payment by the originator to the beneficiary occurs under section 28-4-631[, Idaho Code], and

(iv) subject to section 28-4-627(5)[, Idaho Code], each sender in the funds transfer is excused from its obligation to pay its payment order under section 28-4-627(3)[, Idaho Code], because the funds transfer has not been completed.

History.

I.C., § 28-4-630, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-405 in the uniform act.

The bracketed insertions throughout the section were added by the compiler to conform to the statutory citation style.

Official Comment

1. This section defines when the beneficiary's bank pays the beneficiary and when the obligation of the beneficiary's bank under Section 4A-404 to pay the beneficiary is satisfied. In almost all cases the bank will credit an account of the beneficiary when it receives a payment order. In the typical case the beneficiary is paid when the beneficiary is given notice of the right to withdraw the credit. Subsection (a)(i). In some cases payment might be made to the beneficiary not by releasing funds to the beneficiary, but by applying the credit to a debt of the beneficiary. Subsection (a)(ii). In this case the beneficiary gets the benefit of the payment order because a debt of the beneficiary has been satisfied. The two principal cases in which payment will occur in this manner are setoff by the beneficiary's bank and payment of the proceeds of the payment order to a garnishing creditor of the beneficiary. These cases are discussed in Comment 2 to Section 4A-502.

2. If a beneficiary's bank releases funds to the beneficiary before it receives payment from the sender of the payment order, it assumes the risk that the sender may not pay the sender's order because of suspension of payments or other reason. Subsection (c). As stated in Comment 5 to Section 4A-209, the beneficiary's bank can protect itself against this risk by delaying acceptance. But if the bank accepts the order it is obliged to pay the beneficiary. If the beneficiary's bank has given the beneficiary notice of the right to withdraw a credit made to the beneficiary's account, the beneficiary has received payment from the bank. Once payment has been made to the beneficiary with respect to an obligation incurred by the bank under Section 4A-404(a), the payment cannot be recovered by the beneficiary's bank unless subsection (d) or (e) applies. Thus, a right to withdraw a credit cannot be revoked if the right to withdraw constituted payment of the bank's obligation. This principle applies even if funds were released as a "loan" (see Comment 5 to Section 4A-209), or were released subject to a condition that they would be repaid in the event the bank does not receive payment from the sender of the payment order, or the beneficiary agreed to return the payment if the bank did not receive payment from the sender.

3. Subsection (c) is subject to an exception stated in subsection (d) which is intended to apply to automated clearing house transfers. ACH transfers

are made in batches. A beneficiary's bank will normally accept, at the same time and as part of a single batch, payment orders with respect to many different originator's banks. Comment 2 to Section 4A-206. The custom in ACH transactions is to release funds to the beneficiary early on the payment date even though settlement to the beneficiary's bank does not occur until later in the day. The understanding is that payments to beneficiaries are provisional until the beneficiary's bank receives settlement. This practice is similar to what happens when a depositary bank releases funds with respect to a check forwarded for collection. If the check is dishonored the bank is entitled to recover the funds from the customer. ACH transfers are widely perceived as check substitutes. Section 4A-405(d) allows the funds transfer system to adopt a rule making payments to beneficiaries provisional. If such a rule is adopted, a beneficiary's bank that releases funds to the beneficiary will be able to recover the payment if it doesn't receive payment of the payment order that it accepted. There are two requirements with respect to the funds transfer system rule. The beneficiary, the beneficiary's bank and the originator's bank must all agree to be bound by the rule and the rule must require that both the beneficiary and the originator be given notice of the provisional nature of the payment before the funds transfer is initiated. There is no requirement that the notice be given with respect to a particular funds transfer. Once notice of the provisional nature of the payment has been given, the notice is effective for all subsequent payments to or from the person to whom the notice was given. Subsection (d) provides only that the funds transfer system rule must require notice to the beneficiary and the originator. The beneficiary's bank will know what the rule requires, but it has no way of knowing whether the originator's bank complied with the rule. Subsection (d) does not require proof that the originator received notice. If the originator's bank failed to give the required notice and the originator suffered as a result, the appropriate remedy is an action by the originator against the originator's bank based on that failure. But the beneficiary's bank will not be able to get the benefit of subsection (d) unless the beneficiary had notice of the provisional nature of the payment because subsection (d) requires an agreement by the beneficiary to be bound by the rule. Implicit in an agreement to be bound by a rule that makes a payment provisional is a requirement that notice be given of what the rule provides. The notice can be part of the agreement or separately given. For example, notice can be given by providing a copy of the system's operating rules.

With respect to ACH transfers made through a Federal Reserve Bank acting as an intermediary bank, the Federal Reserve Bank is obliged under Section 4A-402(b) to pay a beneficiary's bank that accepts the payment order. Unlike Fedwire transfers, under current ACH practice a Federal Reserve Bank that processes a payment order does not obligate itself to pay if the originator's bank fails to pay the Federal Reserve Bank. It is assumed that the Federal Reserve will use its right of preemption which is recognized in Section 4A-107 to disclaim the Section 4A-402(b) obligation in ACH transactions if it decides to retain the provisional payment rule.

4. Subsection (e) is another exception to subsection (c). It refers to funds transfer systems having loss-sharing rules described in the subsection. CHIPS has proposed a rule that fits the description. Under the CHIPS loss-sharing rule the CHIPS banks will have agreed to contribute funds to allow the system to settle for payment orders sent over the system during the day in the event that one or more banks are unable to meet their settlement obligations. Subsection (e) applies only if CHIPS fails to settle despite the loss-sharing rule. Since funds under the loss-sharing rule will be instantly available to CHIPS and will be in an amount sufficient to cover any failure that can be reasonably anticipated, it is extremely unlikely that CHIPS would ever fail to settle. Thus, subsection (e) addresses an event that should never occur. If that event were to occur, all payment orders made over the system would be cancelled under the CHIPS rule. Thus, no bank would receive settlement, whether or not a failed bank was involved in a particular funds transfer. Subsection (e) provides that each funds transfer in which there is a payment order with respect to which there is a settlement failure is unwound. Acceptance by the beneficiary's bank in each funds transfer is nullified. The consequences of nullification are that the beneficiary has no right to receive or retain payment by the beneficiary's bank, no payment is made by the originator to the beneficiary and each sender in the funds transfer is, subject to Section 4A-402(e), not obliged to pay its payment order and is entitled to refund under Section 4A-402(d) if it has already paid.

§ 28-4-631. Payment by originator to beneficiary — Discharge of underlying obligation. — (1) Subject to the provisions of sections 28-4-619(5), 28-4-630(4) and (5)[, Idaho Code], the originator of a funds transfer pays the beneficiary of the originator's payment order:

(a) at the time a payment order for the benefit of the beneficiary is accepted by the beneficiary's bank in the funds transfer, and

(b) in an amount equal to the amount of the order accepted by the beneficiary's bank, but not more than the amount of the originator's order.

(2) If payment under subsection (1) of this section is made to satisfy an obligation, the obligation is discharged to the same extent discharge would result from payment to the beneficiary of the same amount in money, unless:

(a) the payment under subsection (1) of this section was made by a means prohibited by the contract of the beneficiary with respect to the obligation,

(b) the beneficiary, within a reasonable time after receiving notice of receipt of the order by the beneficiary's bank, notified the originator of the beneficiary's refusal of the payment,

(c) funds with respect to the order were not withdrawn by the beneficiary or applied to a debt of the beneficiary, and

(d) the beneficiary would suffer a loss that could reasonably have been avoided if payment had been made by a means complying with the contract.

If payment by the originator does not result in discharge under this section, the originator is subrogated to the rights of the beneficiary to receive payment from the beneficiary's bank under section 28-4-629(1)[, Idaho Code].

(3) For the purpose of determining whether discharge of an obligation occurs under subsection (2) of this section, if the beneficiary's bank accepts a payment order in an amount equal to the amount of the originator's

payment order less charges of one (1) or more receiving banks in the funds transfer, payment to the beneficiary is deemed to be in the amount of the originator's order unless upon demand by the beneficiary the originator does not pay the beneficiary the amount of the deducted charges.

(4) Rights of the originator or of the beneficiary of a funds transfer under this section may be varied only by agreement of the originator and the beneficiary.

History.

I.C., § 28-4-631, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-406 in the uniform act.

The bracketed insertions in the introductory paragraph in subsection (1) and at the end of subsection (2) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Subsection (a) states the fundamental rule of Article 4A that payment by the originator to the beneficiary is accomplished by providing to the beneficiary the obligation of the beneficiary's bank to pay. Since this obligation arises when the beneficiary's bank accepts a payment order, the originator pays the beneficiary at the time of acceptance and in the amount of the payment order accepted.

2. In a large percentage of funds transfers, the transfer is made to pay an obligation of the originator. Subsection (a) states that the beneficiary is paid by the originator when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. When that happens the effect under subsection (b) is to substitute the obligation of the beneficiary's bank for the obligation of the originator. The effect is similar to that under Article 3 if a cashier's check payable to the beneficiary had been taken by the beneficiary. Normally, payment by funds transfer is sought by the beneficiary because it puts money into the hands of the beneficiary more quickly. As a practical

matter the beneficiary and the originator will nearly always agree to the funds transfer in advance. Under subsection (b) acceptance by the beneficiary's bank will result in discharge of the obligation for which payment was made unless the beneficiary had made a contract with respect to the obligation which did not permit payment by the means used. Thus, if there is no contract of the beneficiary with respect to the means of payment of the obligation, acceptance by the beneficiary's bank of a payment order to the account of the beneficiary can result in discharge.

3. Suppose Beneficiary's contract stated that payment of an obligation owed by Originator was to be made by a cashier's check of Bank A. Instead Originator paid by a funds transfer to Beneficiary's account in Bank B. Bank B accepted a payment order for the benefit of Beneficiary by immediately notifying Beneficiary that the funds were available for withdrawal. Before Beneficiary had a reasonable opportunity to withdraw the funds Bank B suspended payments. Under the unless clause of subsection (b) Beneficiary is not required to accept the payment as discharging the obligation owed by Originator to Beneficiary if Beneficiary's contract means that Beneficiary was not required to accept payment by wire transfer. Beneficiary could refuse the funds transfer as payment of the obligation and could resort to rights under the underlying contract to enforce the obligation. The rationale is that Originator cannot impose the risk of Bank B's insolvency on Beneficiary if Beneficiary had specified another means of payment that did not entail that risk. If Beneficiary is required to accept Originator's payment, Beneficiary would suffer a loss that would not have occurred if payment had been made by a cashier's check on Bank A, and Bank A has not suspended payments. In this case Originator will have to pay twice. It is obliged to pay the amount of its payment order to the bank that accepted it and has to pay the obligation it owes to Beneficiary which has not been discharged. Under the last sentence of subsection (b) Originator is subrogated to Beneficiary's right to receive payment from Bank B under Section 4A-404(a).

4. Suppose Beneficiary's contract called for payment by a Fedwire transfer to Bank B, but the payment order accepted by Bank B was not a Fedwire transfer. Before the funds were withdrawn by Beneficiary, Bank B suspended payments. The sender of the payment order to Bank B paid the amount of the order to Bank B. In this case the payment by Originator did

not comply with Beneficiary's contract, but the noncompliance did not result in a loss to Beneficiary as required by subsection (b)(iv). A Fedwire transfer avoids the risk of insolvency of the sender of the payment order to Bank B, but it does not affect the risk that Bank B will suspend payments before withdrawal of the funds by Beneficiary. Thus, the unless clause of subsection (b) is not applicable and the obligation owed to Beneficiary is discharged.

5. Charges of receiving banks in a funds transfer normally are nominal in relationship to the amount being paid by the originator to the beneficiary. Wire transfers are normally agreed to in advance and the parties may agree concerning how these charges are to be divided between the parties. Subsection (c) states a rule that applies in the absence of agreement. In some funds transfers charges of banks that execute payment orders are collected by deducting the charges from the amount of the payment order issued by the bank, *i.e.* the bank issues a payment order that is slightly less than the amount of the payment order that is being executed. The process is described in Comment 3 to Section 4A-302. The result in such a case is that the payment order accepted by the beneficiary's bank will be slightly less than the amount of the originator's order. Subsection (c) recognizes the principle that a beneficiary is entitled to full payment of a debt paid by wire transfer as a condition to discharge. On the other hand, subsection (c) prevents a beneficiary from denying the originator the benefit of the payment by asserting that discharge did not occur because deduction of bank charges resulted in less than full payment. The typical case is one in which the payment is made to exercise a valuable right such as an option which is unfavorable to the beneficiary. Subsection (c) allows discharge notwithstanding the deduction unless the originator fails to reimburse the beneficiary for the deducted charges after demand by the beneficiary.

§ 28-4-632. Variation by agreement and effect of funds-transfer system rule. — (1) Except as otherwise provided in this part, the rights and obligations of a party to a funds transfer may be varied by agreement of the affected party.

(2) "Funds-transfer system rule" means a rule of an association of banks:

(a) governing transmission of payment orders by means of a funds-transfer system of the association or rights and obligations with respect to those orders, or

(b) to the extent the rule governs rights and obligations between banks that are parties to a funds transfer in which a Federal Reserve bank, acting as an intermediary bank, sends a payment order to the beneficiary's bank.

Except as otherwise provided in this part, a funds-transfer system rule governing rights and obligations between participating banks using the system may be effective even if the rule conflicts with this part and indirectly affects another party to the funds transfer who does not consent to the rule. A funds-transfer system rule may also govern rights and obligations of parties other than participating banks using the system to the extent stated in sections 28-4-629(3), 28-4-630(4), and 28-4-638(3)[, Idaho Code].

History.

I.C., § 28-4-632, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-501 in the uniform act.

The bracketed insertion at the end of subsection (2) was added by the compiler to conform to the statutory citation style.

Official Comment

1. This section is designed to give some flexibility to Article 4A. Funds transfer system rules govern rights and obligations between banks that use the system. They may cover a wide variety of matters such as form and content of payment orders, security procedures, cancellation rights and procedures, indemnity rights, compensation rules for delays in completion of a funds transfer, time and method of settlement, credit restrictions with respect to senders of payment orders and risk allocation with respect to suspension of payments by a participating bank. Funds transfer system rules can be very effective in supplementing the provisions of Article 4A and in filling gaps that may be present in Article 4A. To the extent they do not conflict with Article 4A there is no problem with respect to their effectiveness. In that case they merely supplement Article 4A. Section 4A-501 goes further. It states that unless the contrary is stated, funds transfer system rules can override provisions of Article 4A. Thus, rights and obligations of a sender bank and a receiving bank with respect to each other can be different from that stated in Article 4A to the extent a funds transfer system rule applies. Since funds transfer system rules are defined as those governing the relationship between participating banks, a rule can have a direct effect only on participating banks. But a rule that affects the conduct of a participating bank may indirectly affect the rights of nonparticipants such as the originator or beneficiary of a funds transfer, and such a rule can be effective even though it may affect nonparticipants without their consent. For example, a rule might prevent execution of a payment order or might allow cancellation of a payment order with the result that a funds transfer is not completed or is delayed. But a rule purporting to define rights and obligations of nonparticipants in the system would not be effective to alter Article 4A rights because the rule is not within the definition of funds transfer system rule. Rights and obligations arising under Article 4A may also be varied by agreement of the affected parties, except to the extent Article 4A otherwise provides. Rights and obligations arising under Article 4A can also be changed by Federal Reserve regulations and operating circulars of Federal Reserve Banks. Section 4A-107.

2. Subsection (b)(ii) refers to ACH transfers. Whether an ACH transfer is made through an automated clearing house of a Federal Reserve Bank or through an automated clearing house of another association of banks, the

rights and obligations of the originator's bank and the beneficiary's bank are governed by uniform rules adopted by various associations of banks in various parts of the nation. With respect to transfers in which a Federal Reserve Bank acts as intermediary bank these rules may be incorporated, in whole or in part, in operating circulars of the Federal Reserve Bank. Even if not so incorporated these rules can still be binding on the association banks. If a transfer is made through a Federal Reserve Bank, the rules are effective under subsection (b)(ii). If the transfer is not made through a Federal Reserve Bank, the association rules are effective under subsection (b)(i).

§ 28-4-633. Creditor process served on receiving bank — Setoff by beneficiary's bank. — (1) As used in this section, "creditor process" means levy, attachment, garnishment, notice of lien, sequestration, or similar process issued by or on behalf of a creditor or other claimant with respect to an account.

(2) The provisions of this subsection apply to creditor process with respect to an authorized account of the sender of a payment order if the creditor process is served on the receiving bank. For the purpose of determining rights with respect to the creditor process, if the receiving bank accepts the payment order the balance in the authorized account is deemed to be reduced by the amount of the payment order to the extent the bank did not otherwise receive payment of the order, unless the creditor process is served at a time and in a manner affording the bank a reasonable opportunity to act on it before the bank accepts the payment order.

(3) If a beneficiary's bank has received a payment order for payment to the beneficiary's account in the bank, the following rules apply:

(a) The bank may credit the beneficiary's account. The amount credited may be set off against an obligation owed by the beneficiary to the bank or may be applied to satisfy creditor process served on the bank with respect to the account.

(b) The bank may credit the beneficiary's account and allow withdrawal of the amount credited unless creditor process with respect to the account is served at a time and in a manner affording the bank a reasonable opportunity to act to prevent withdrawal.

(c) If creditor process with respect to the beneficiary's account has been served and the bank has had a reasonable opportunity to act on it, the bank may not reject the payment order except for a reason unrelated to the service of process.

(4) Creditor process with respect to a payment by the originator to the beneficiary pursuant to a funds transfer may be served only on the beneficiary's bank with respect to the debt owed by that bank to the

beneficiary. Any other bank served with the creditor process is not obliged to act with respect to the process.

History.

I.C., § 28-4-633, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-502 in the uniform act.

Official Comment

1. When a receiving bank accepts a payment order, the bank normally receives payment from the sender by debiting an authorized account of the sender. In accepting the sender's order the bank may be relying on a credit balance in the account. If creditor process is served on the bank with respect to the account before the bank accepts the order but the bank employee responsible for the acceptance was not aware of the creditor process at the time the acceptance occurred, it is unjust to the bank to allow the creditor process to take the credit balance on which the bank may have relied. Subsection (b) allows the bank to obtain payment from the sender's account in this case. Under that provision, the balance in the sender's account to which the creditor process applies is deemed to be reduced by the amount of the payment order unless there was sufficient time for notice of the service of creditor process to be received by personnel of the bank responsible for the acceptance.

2. Subsection (c) deals with payment orders issued to the beneficiary's bank. The bank may credit the beneficiary's account when the order is received, but under Section 4A-404(a) the bank incurs no obligation to pay the beneficiary until the order is accepted pursuant to Section 4A-209(b). Thus, before acceptance, the credit to the beneficiary's account is provisional. But under Section 4A-209(b) acceptance occurs if the beneficiary's bank pays the beneficiary pursuant to Section 4A-405(a). Under that provision, payment occurs if the credit to the beneficiary's account is applied to a debt of the beneficiary. Subsection (c)(1) allows the bank to credit the beneficiary's account with respect to a payment order and

to accept the order by setting off the credit against an obligation owed to the bank or applying the credit to creditor process with respect to the account.

Suppose a beneficiary's bank receives a payment order for the benefit of a customer. Before the bank accepts the order, the bank learns that creditor process has been served on the bank with respect to the customer's account. Normally there is no reason for a beneficiary's bank to reject a payment order, but if the beneficiary's account is garnished, the bank may be faced with a difficult choice. If it rejects the order, the garnishing creditor's potential recovery of funds of the beneficiary is frustrated. It may be faced with a claim by the creditor that the rejection was a wrong to the creditor. If the bank accepts the order, the effect is to allow the creditor to seize funds of its customer, the beneficiary. Subsection (c)(3) gives the bank no choice in this case. It provides that it may not favor its customer over the creditor by rejecting the order. The beneficiary's bank may rightfully reject only if there is an independent basis for rejection.

3. Subsection (c)(2) is similar to subsection (b). Normally the beneficiary's bank will release funds to the beneficiary shortly after acceptance or it will accept by releasing funds. Since the bank is bound by a garnishment order served before funds are released to the beneficiary, the bank might suffer a loss if funds were released without knowledge that a garnishment order had been served. Subsection (c)(2) protects the bank if it did not have adequate notice of the garnishment when the funds were released.

4. A creditor may want to reach funds involved in a funds transfer. The creditor may try to do so by serving process on the originator's bank, an intermediary bank or the beneficiary's bank. The purpose of subsection (d) is to guide the creditor and the court as to the proper method of reaching the funds involved in a funds transfer. A creditor of the originator can levy on the account of the originator in the originator's bank before the funds transfer is initiated, but that levy is subject to the limitations stated in subsection (b). The creditor of the originator cannot reach any other funds because no property of the originator is being transferred. A creditor of the beneficiary cannot levy on property of the originator and until the funds transfer is completed by acceptance by the beneficiary's bank of a payment order for the benefit of the beneficiary, the beneficiary has no property interest in the funds transfer which the beneficiary's creditor can reach. A

creditor of the beneficiary that wants to reach the funds to be received by the beneficiary must serve creditor process on the beneficiary's bank to reach the obligation of the beneficiary's bank to pay the beneficiary which arises upon acceptance by the beneficiary's bank under Section 4A-404(a).

5. "Creditor process" is defined in subsection (a) to cover a variety of devices by which a creditor of the holder of a bank account or a claimant to a bank account can seize the account. Procedure and nomenclature varies widely from state to state. The term used in Section 4A-502 is a generic term.

§ 28-4-634. Injunction or restraining order with respect to funds transfer. — For proper cause and in compliance with applicable law, a court may restrain:

(1) A person from issuing a payment order to initiate a funds transfer, (2) An originator's bank from executing the payment order of the originator, or (3) The beneficiary's bank from releasing funds to the beneficiary or the beneficiary from withdrawing the funds.

A court may not otherwise restrain a person from issuing a payment order, paying or receiving payment of a payment order, or otherwise acting with respect to a funds transfer.

History.

I.C., § 28-4-634, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-503 in the uniform act.

Official Comment This section is related to Section 4A-502(d) and to Comment 4 to Section 4A-502. It is designed to prevent interruption of a funds transfer after it has been set in motion. The initiation of a funds transfer can be prevented by enjoining the originator or the originator's bank from issuing a payment order. After the funds transfer is completed by acceptance of a payment order by the beneficiary's bank, that bank can be enjoined from releasing funds to the beneficiary or the beneficiary can be enjoined from withdrawing the funds. No other injunction is permitted. In particular, intermediary banks are protected, and injunctions against the originator and the originator's bank are limited to issuance of a payment order. Except for the beneficiary's bank, nobody can be enjoined from paying a payment order, and no receiving bank can be enjoined from receiving payment from the sender of the order that it accepted.

§ 28-4-635. Order in which items and payment orders may be charged to account — Order of withdrawals from account. — (1) If a receiving bank has received more than one (1) payment order of the sender or one (1) or more payment orders and other items that are payable from the sender's account, the bank may charge the sender's account with respect to the various orders and items in any sequence.

(2) In determining whether a credit to an account has been withdrawn by the holder of the account or applied to a debt of the holder of the account, credits first made to the account are first withdrawn or applied.

History.

I.C., § 28-4-635, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-504 in the uniform act.

Official Comment 1. Subsection (a) concerns priority among various obligations that are to be paid from the same account. A customer may have written checks on its account with the receiving bank and may have issued one or more payment orders payable from the same account. If the account balance is not sufficient to cover all of the checks and payment orders, some checks may be dishonored and some payment orders may not be accepted. Although there is no concept of wrongful dishonor of a payment order in Article 4A in the absence of an agreement to honor by the receiving bank, some rights and obligations may depend on the amount in the customer's account. Section 4A-209(b)(3) and Section 4A-210(b). Whether dishonor of a check is wrongful also may depend upon the balance in the customer's account. Under subsection (a), the bank is not required to consider the competing items and payment orders in any particular order. Rather it may charge the customer's account for the various items and orders in any order. Suppose there is $12,000 in the customer's account. If a

check for $5,000 is presented for payment and the bank receives a $10,000 payment order from the customer, the bank could dishonor the check and accept the payment order. Dishonor of the check is not wrongful because the account balance was less than the amount of the check after the bank charged the account $10,000 on account of the payment order. Or, the bank could pay the check and not execute the payment order because the amount of the order is not covered by the balance in the account.

2. Subsection (b) follows Section 4-208(b) in using the first-in-first-out rule for determining the order in which credits to an account are withdrawn.

§ 28-4-636. Preclusion of objection to debit of customer's account. — If a receiving bank has received payment from its customer with respect to a payment order issued in the name of the customer as sender and accepted by the bank, and the customer received notification reasonably identifying the order, the customer is precluded from asserting that the bank is not entitled to retain the payment unless the customer notifies the bank of the customer's objection to the payment within one (1) year after the notification was received by the customer.

History.

I.C., § 28-4-636, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-505 in the uniform act.

Official Comment This section is in the nature of a statute of repose for objecting to debits made to the customer's account. A receiving bank that executes payment orders of a customer may have received payment from the customer by debiting the customer's account with respect to a payment order that the customer was not required to pay. For example, the payment order may not have been authorized or verified pursuant to Section 4A-202 or the funds transfer may not have been completed. In either case the receiving bank is obliged to refund the payment to the customer and this obligation to refund payment cannot be varied by agreement. Section 4A-204 and Section 4A-402. Refund may also be required if the receiving bank is not entitled to payment from the customer because the bank erroneously executed a payment order. Section 4A-303. A similar analysis applies to that case. Section 4A-402(d) and (f) require refund and the obligation to refund may not be varied by agreement. Under 4A-505, however, the obligation to refund may not be asserted by the customer if the customer has not objected to the debiting of the account within one year after the customer received notification of the debit.

§ 28-4-637. Rate of interest. — (1) If, under this part, a receiving bank is obliged to pay interest with respect to a payment order issued to the bank, the amount payable may be determined:

(a) by agreement of the sender and receiving bank, or (b) by a funds-transfer system rule if the payment order is transmitted through a funds-transfer system.

(2) If the amount of interest is not determined by an agreement or rule as stated in subsection (1) of this section, the amount is calculated by multiplying the applicable federal funds rate by the amount on which interest is payable, and then multiplying the product by the number of days for which interest is payable. The applicable federal funds rate is the average of the federal funds rates published by the Federal Reserve bank of New York for each of the days for which interest is payable divided by three hundred and sixty (360). The federal funds rate for any day on which a published rate is not available is the same as the published rate for the next preceding day for which there is a published rate. If a receiving bank that accepted a payment order is required to refund payment to the sender of the order because the funds transfer was not completed, but the failure to complete was not due to any fault by the bank, the interest payable is reduced by a percentage equal to the reserve requirement on deposits of the receiving bank.

History.

I.C., § 28-4-637, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-506 in the uniform act.

Official Comment 1. A receiving bank is required to pay interest on the amount of a payment order received by the bank in a number of situations. Sometimes the interest is payable to the sender and in other cases it is payable to either the originator or the beneficiary of the

funds transfer. The relevant provisions are Section 4A-204(a), Section 4A-209(b)(3), Section 4A-210(b), Section 4A-305(a), Section 4A-402(d) and Section 4A-404(b). The rate of interest may be governed by a funds transfer system rule or by agreement as stated in subsection (a). If subsection (a) doesn't apply, the rate is determined under subsection (b). Subsection (b) is illustrated by the following example. A bank is obliged to pay interest on $1,000,000 for three days, July 3, July 4, and July 5. The published Fed Funds rate is .082 for July 3 and .081 for July 5. There is no published rate for July 4 because that day is not a banking day. The rate for July 3 applies to July 4. The applicable Fed Funds rate is .08167 (the average of .082, .082, and .081) divided by 360 which equals .0002268. The amount of interest payable is $1,000,000 X .0002268 X 3 = $680.40.

2. In some cases, interest is payable in spite of the fact that there is no fault by the receiving bank. The last sentence of subsection (b) applies to those cases. For example, a funds transfer might not be completed because the beneficiary's bank rejected the payment order issued to it by the originator's bank or an intermediary bank. Section 4A-402(c) provides that the originator is not obliged to pay its payment order and Section 4A-402(d) provides that the originator's bank must refund any payment received plus interest. The requirement to pay interest in this case is not based on fault by the originator's bank. Rather, it is based on restitution. Since the originator's bank had the use of the originator's money, it is required to pay the originator for the value of that use. The value of that use is not determined by multiplying the interest rate by the refundable amount because the originator's bank is required to deposit with the Federal Reserve a percentage of the bank's deposits as a reserve requirement. Since that deposit does not bear interest, the bank had use of the refundable amount reduced by a percentage equal to the reserve requirement. If the reserve requirement is 12%, the amount of interest payable by the bank under the formula stated in subsection (b) is reduced by 12%.

§ 28-4-638. Choice of law. — (1) The following rules apply unless the affected parties otherwise agree or the provisions of subsection (3) of this section apply:

(a) The rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located.

(b) The rights and obligations between the beneficiary's bank and the beneficiary are governed by the law of the jurisdiction in which the beneficiary's bank is located.

(c) The issue of when payment is made pursuant to a funds transfer by the originator to the beneficiary is governed by the law of the jurisdiction in which the beneficiary's bank is located.

(2) If the parties described in paragraphs (a), (b) and (c) of subsection (1) of this section have made an agreement selecting the law of a particular jurisdiction to govern rights and obligations between each other, the law of that jurisdiction governs those rights and obligations, whether or not the payment order or the funds transfer bears a reasonable relation to that jurisdiction.

(3) A funds-transfer system rule may select the law of a particular jurisdiction to govern:

(a) rights and obligations between participating banks with respect to payment orders transmitted or processed through the system, or

(b) the rights and obligations of some or all parties to a funds transfer any part of which is carried out by means of the system.

A choice of law made pursuant to paragraph (a) of this subsection is binding on participating banks. A choice of law made pursuant to paragraph (b) of this subsection is binding on the originator, other sender, or a receiving bank having notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system when the originator, other sender, or receiving bank issued or accepted a payment order. The beneficiary of a funds transfer is bound by the choice of law if,

when the funds transfer is initiated, the beneficiary has notice that the funds-transfer system might be used in the funds transfer and of the choice of law by the system. The law of a jurisdiction selected pursuant to this subsection may govern, whether or not that law bears a reasonable relation to the matter in issue.

(4) In the event of inconsistency between an agreement under subsection (2) of this section and a choice-of-law rule under subsection (3) of this section, the agreement under subsection (2) of this section prevails.

(5) If a funds transfer is made by use of more than one (1) funds-transfer system and there is inconsistency between choice-of-law rules of the systems, the matter in issue is governed by the law of the selected jurisdiction that has the most significant relationship to the matter in issue.

History.

I.C., § 28-4-638, as added by 1991, ch. 135, § 1, p. 295.

STATUTORY NOTES

Compiler's Notes.

This section is designated as section 4A-507 in the uniform act.

RESEARCH REFERENCES

Idaho Law Review. — Choice of Law in Idaho: A Survey and Critique of Idaho Cases, Andrew S. Jorgensen. 49 Idaho L. Rev. 547 (2013).

Official Comment

1. Funds transfers are typically interstate or international in character. If part of a funds transfer is governed by Article 4A and another part is governed by other law, the rights and obligations of parties to the funds transfer may be unclear because there is no clear consensus in various jurisdictions concerning the juridical nature of the transaction. Unless all of a funds transfer is governed by a single law it may be very difficult to predict the result if something goes wrong in the transfer. Section 4A-507 deals with this problem. Subsection (b) allows parties to a funds transfer to make a choice-of-law agreement. Subsection (c) allows a funds transfer

system to select the law of a particular jurisdiction to govern funds transfers carried out by means of the system. Subsection (a) states residual rules if no choice of law has occurred under subsection (b) or subsection (c).

2. Subsection (a) deals with three sets of relationships. Rights and obligations between the sender of a payment order and the receiving bank are governed by the law of the jurisdiction in which the receiving bank is located. If the receiving bank is the beneficiary's bank the rights and obligations of the beneficiary are also governed by the law of the jurisdiction in which the receiving bank is located. Suppose Originator, located in Canada, sends a payment order to Originator's Bank located in a state in which Article 4A has been enacted. The order is for payment to an account of Beneficiary in a bank in England. Under subsection (a)(1), the rights and obligations of Originator and Originator's Bank toward each other are governed by Article 4A if an action is brought in a court in the Article 4A state. If an action is brought in a Canadian court, the conflict of laws issue will be determined by Canadian law which might or might not apply the law of the state in which Originator's Bank is located. If that law is applied, the execution of Originator's order will be governed by Article 4A, but with respect to the payment order of Originator's Bank to the English bank, Article 4A may or may not be applied with respect to the rights and obligations between the two banks. The result may depend upon whether action is brought in a court in the state in which Originator's Bank is located or in an English court. Article 4A is binding only on a court in a state that enacts it. It can have extraterritorial effect only to the extent courts of another jurisdiction are willing to apply it. Subsection (c) also bears on the issues discussed in this Comment.

Under Section 4A-406 payment by the originator to the beneficiary of the funds transfer occurs when the beneficiary's bank accepts a payment order for the benefit of the beneficiary. A jurisdiction in which Article 4A is not in effect may follow a different rule or it may not have a clear rule. Under Section 4A-507(a)(3) the issue is governed by the law of the jurisdiction in which the beneficiary's bank is located. Since the payment to the beneficiary is made through the beneficiary's bank it is reasonable that the issue of when payment occurs be governed by the law of the jurisdiction in which the bank is located. Since it is difficult in many cases to determine

where a beneficiary is located, the location of the beneficiary's bank provides a more certain rule.

3. Subsection (b) deals with choice-of-law agreements and it gives maximum freedom of choice. Since the law of funds transfers is not highly developed in the case law there may be a strong incentive to choose the law of a jurisdiction in which Article 4A is in effect because it provides a greater degree of certainty with respect to the rights of various parties. With respect to commercial transactions, it is often said that "[u]niformity and predictability based upon commercial convenience are the prime considerations in making the choice of governing law . . .." R. Leflar, American Conflicts Law, § 185 (1977). Subsection (b) is derived in part from recently enacted choice-of-law rules in the States of New York and California. N.Y. Gen. Obligations Law 5-1401 (McKinney's 1989 Supp.) and California Civil Code § 1646.5. This broad endorsement of freedom of contract is an enhancement of the approach taken by Restatement (Second) of Conflict of Laws § 187(b) (1971). The Restatement recognizes the basic right of freedom of contract, but the freedom granted the parties may be more limited than the freedom granted here. Under the formulation of the Restatement, if there is no substantial relationship to the jurisdiction whose law is selected and there is no "other" reasonable basis for the parties' choice, then the selection of the parties need not be honored by a court. Further, if the choice is violative of a fundamental policy of a state which has a materially greater interest than the chosen state, the selection could be disregarded by a court. Those limitations are not found in subsection (b).

4. Subsection (c) may be the most important provision in regard to creating uniformity of law in funds transfers. Most rights stated in Article 4A regard parties who are in privity of contract such as originator and beneficiary, sender and receiving bank, and beneficiary's bank and beneficiary. Since they are in privity they can make a choice of law by agreement. But that is not always the case. For example, an intermediary bank that improperly executes a payment order is not in privity with either the originator or the beneficiary. The ability of a funds transfer system to make a choice of law by rule is a convenient way of dispensing with individual agreements and to cover cases in which agreements are not feasible. It is probable that funds transfer systems will adopt a governing law to increase the certainty of commercial transactions that are effected

over such systems. A system rule might adopt the law of an Article 4A state to govern transfers on the system in order to provide a consistent, unitary, law governing all transfers made on the system. To the extent such system rules develop, individual choice-of-law agreements become unnecessary.

Subsection (c) has broad application. A system choice of law applies not only to rights and obligations between banks that use the system, but may also apply to other parties to the funds transfer so long as some part of the transfer was carried out over the system. The originator and any other sender or receiving bank in the funds transfer is bound if at the time it issues or accepts a payment order it had notice that the funds transfer involved use of the system and that the system chose the law of a particular jurisdiction. Under Section 4A-107, the Federal Reserve by regulation could make a similar choice of law to govern funds transfers carried out by use of Federal Reserve Banks. Subsection (d) is a limitation on subsection (c). If parties have made a choice-of-law agreement that conflicts with a choice of law made under subsection (c), the agreement prevails.

5. Subsection (e) addresses the case in which a funds transfer involves more than one funds transfer system and the systems adopt conflicting choice-of-law rules. The rule that has the most significant relationship to the matter at issue prevails. For example, each system should be able to make a choice of law governing payment orders transmitted over that system without regard to a choice of law made by another system.

Chapter 5
UNIFORM COMMERCIAL CODE — LETTERS OF CREDIT

Sec.

§ 28-5-101. Short title. — This chapter may be cited as "Uniform Commercial Code — Letters of Credit."

History.

I.C., § 28-5-101, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-101, which comprised S.L. 1967, ch. 161, § 5-101, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Compiler's Notes.

The official comments in chapters 1 to 12 of this title are copyrighted by the National Conference of Commissioners of Uniform State Laws and the American Law Institute and are reproduced by permission.

Official Comment

The Official Comment to the original Section 5-101 was a remarkably brief inaugural address. Noting that letters of credit had not been the subject of statutory enactment and that the law concerning them had been developed in the cases, the Comment stated that Article 5 was intended "within its limited scope" to set an independent theoretical frame for the further development of letters of credit. That statement addressed accurately conditions as they existed when the statement was made, nearly half a century ago. Since Article 5 was originally drafted, the use of letters of credit has expanded and developed, and the case law concerning these developments is, in some respects, discordant.

Revision of Article 5 therefore has required reappraisal both of the statutory goals and of the extent to which particular statutory provisions further or adversely affect achievement of those goals.

The statutory goal of Article 5 was originally stated to be: (1) to set a substantive theoretical frame that describes the function and legal nature of

letters of credit; and (2) to preserve procedural flexibility in order to accommodate further development of the efficient use of letters of credit. A letter of credit is an idiosyncratic form of undertaking that supports performance of an obligation incurred in a separate financial, mercantile, or other transaction or arrangement. The objectives of the original and revised Article 5 are best achieved (1) by defining the peculiar characteristics of a letter of credit that distinguish it and the legal consequences of its use from other forms of assurance such as secondary guarantees, performance bonds, and insurance policies, and from ordinary contracts, fiduciary engagements, and escrow arrangements; and (2) by preserving flexibility through variation by agreement in order to respond to and accommodate developments in custom and usage that are not inconsistent with the essential definitions and substantive mandates of the statute. No statute can, however, prescribe the manner in which such substantive rights and duties are to be enforced or imposed without risking stultification of wholesome developments in the letter of credit mechanism. Letter of credit law should remain responsive to commercial reality and in particular to the customs and expectations of the international banking and mercantile community. Courts should read the terms of this article in a manner consistent with these customs and expectations.

The subject matter in Article 5, letters of credit, may also be governed by an international convention that is now being drafted by UNCITRAL, the draft Convention on Independent Guarantees and Standby Letters of Credit. The Uniform Customs and Practice is an international body of trade practice that is commonly adopted by international and domestic letters of credit and as such is the "law of the transaction" by agreement of the parties. Article 5 is consistent with and was influenced by the rules in the existing version of the UCP. In addition to the UCP and the international convention, other bodies of law apply to letters of credit. For example, the federal bankruptcy law applies to letters of credit with respect to applicants and beneficiaries that are in bankruptcy; regulations of the Federal Reserve Board and the Comptroller of the Currency lay out requirements for banks that issue letters of credit and describe how letters of credit are to be treated for calculating asset risk and for the purpose of loan limitations. In addition there is an array of anti-boycott and other similar laws that may affect the issuance and performance of letters of credit. All of these laws are beyond

the scope of Article 5, but in certain circumstances they will override Article 5.

§ 28-5-102. Definitions. — (1) In this chapter:

(a) "Adviser" means a person who, at the request of the issuer, a confirmer, or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amended.

(b) "Applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(c) "Beneficiary" means a person who, under the terms of a letter of credit, is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(d) "Confirmer" means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(e) "Dishonor" of a letter of credit means failure to timely honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(f) "Document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion (i) which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in section 28-5-108(5)[, Idaho Code,] and (ii) which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(g) "Good faith" means honesty in fact in the conduct or transaction concerned.

(h) "Honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value.

Unless the letter of credit otherwise provides, “honor” occurs

(i) upon payment,

(ii) if the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment, or

(iii) if the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(i) “Issuer” means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

(j) “Letter of credit” means a definite undertaking that satisfies the requirements of section 28-5-104[, Idaho Code,] by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

(k) “Nominated person” means a person whom the issuer (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse.

(l) “Presentation” means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

(m) “Presenter” means a person making a presentation as or on behalf of a beneficiary or nominated person.

(n) “Record” means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form.

(o) “Successor of a beneficiary” means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

(2) Definitions in other chapters applying to this chapter and the sections in which they appear are:

"Accept" or "Acceptance" Section 28-3-409[, Idaho Code]

"Value" Sections 28-3-303, 28-4-211[, Idaho Code]

(3) Chapter 1, title 28, Idaho Code, contains certain additional general definitions and principles of construction and interpretation applicable throughout this chapter.

History.

I.C., § 28-5-102, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-102, which comprised 1967, ch. 161, § 5-102, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Compiler's Notes.

The bracketed insertions in paragraphs (1)(f) and (1)(j) and subsection (2) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Since no one can be a confirmer unless that person is a nominated person as defined in Section 5-102(a)(11), those who agree to "confirm" without the designation or authorization of the issuer are not confirmers under Article 5. Nonetheless, the undertakings to the beneficiary of such persons may be enforceable by the beneficiary as letters of credit issued by the "confirmer" for its own account or as guarantees or contracts outside of Article 5.

2. The definition of "document" contemplates and facilitates the growing recognition of electronic and other nonpaper media as "documents," however, for the time being, data in those media constitute documents only in certain circumstances. For example, a facsimile received by an issuer would be a document only if the letter of credit explicitly permitted it, if the standard practice authorized it and the letter did not prohibit it, or the

agreement of the issuer and beneficiary permitted it. The fact that data transmitted in a nonpaper (unwritten) medium can be recorded on paper by a recipient's computer printer, facsimile machine, or the like does not under current practice render the data so transmitted a "document." A facsimile or S.W.I.F.T. message received directly by the issuer is in an electronic medium when it crosses the boundary of the issuer's place of business. One wishing to make a presentation by facsimile (an electronic medium) will have to procure the explicit agreement of the issuer (assuming that the standard practice does not authorize it). Article 5 contemplates that electronic documents may be presented under a letter of credit and the provisions of this Article should be read to apply to electronic documents as well as tangible documents. An electronic document of title is delivered through the voluntary transfer of control. Article 1, Section 1-201 (definition of "delivery"). See Article 7, Section 7-106 on control of an electronic document. Where electronic transmissions are authorized neither by the letter of credit nor by the practice, the beneficiary may transmit the data electronically to its agent who may be able to put it in written form and make a conforming presentation. Cf. Article 7, Section 7-105 on reissuing an electronic document in a tangible medium.

3. "Good faith" continues in revised Article 5 to be defined as "honesty in fact." "Observance of reasonable standards of fair dealing" has not been added to the definition. The narrower definition of "honesty in fact" reinforces the "independence principle" in the treatment of "fraud," "strict compliance," "preclusion," and other tests affecting the performance of obligations that are unique to letters of credit. This narrower definition — which does not include "fair dealing" — is appropriate to the decision to honor or dishonor a presentation of documents specified in a letter of credit. The narrower definition is also appropriate for other parts of revised Article 5 where greater certainty of obligations is necessary and is consistent with the goals of speed and low cost. It is important that U.S. letters of credit have continuing vitality and competitiveness in international transactions.

For example, it would be inconsistent with the "independence" principle if any of the following occurred: (i) the beneficiary's failure to adhere to the standard of "fair dealing" in the underlying transaction or otherwise in presenting documents were to provide applicants and issuers with an "unfairness" defense to dishonor even when the documents complied with

the terms of the letter of credit; (ii) the issuer's obligation to honor in "strict compliance in accordance with standard practice" were changed to "reasonable compliance" by use of the "fair dealing" standard, or (iii) the preclusion against the issuer (Section 5-108(d)) were modified under the "fair dealing" standard to enable the issuer later to raise additional deficiencies in the presentation. The rights and obligations arising from presentation, honor, dishonor and reimbursement, are independent and strict, and thus "honesty in fact" is an appropriate standard.

The contract between the applicant and beneficiary is not governed by Article 5, but by applicable contract law, such as Article 2 or the general law of contracts. "Good faith" in that contract is defined by other law, such as Section 2-103(1)(b) or Restatement of Contracts 2d, § 205, which incorporate the principle of "fair dealing" in most cases, or a State's common law or other statutory provisions that may apply to that contract.

The contract between the applicant and the issuer (sometimes called the "reimbursement" agreement) is governed in part by this article (e.g., Sections 5-108(i), 5-111(b), and 5-103(c)) and partly by other law (e.g., the general law of contracts). The definition of good faith in Section 5-102(a)(7) applies only to the extent that the reimbursement contract is governed by provisions in this article; for other purposes good faith is defined by other law.

4. Payment and acceptance are familiar modes of honor. A third mode of honor, incurring an unconditional obligation, has legal effects similar to an acceptance of a time draft but does not technically constitute an acceptance. The practice of making letters of credit available by "deferred payment undertaking" as now provided in UCP 500 has grown up in other countries and spread to the United States. The definition of "honor" will accommodate that practice.

5. The exclusion of consumers from the definition of "issuer" is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5, the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16 CFR Part 433. In a consumer transaction, an individual cannot

be an issuer where that person would otherwise be either the principal debtor or a guarantor.

6. The label on a document is not conclusive; certain documents labelled "guarantees" in accordance with European (and occasionally, American) practice are letters of credit. On the other hand, even documents that are labelled "letter of credit" may not constitute letters of credit under the definition in Section 5-102(a). When a document labelled a letter of credit requires the issuer to pay not upon the presentation of documents, but upon the determination of an extrinsic fact such as applicant's failure to perform a construction contract, and where that condition appears on its face to be fundamental and would, if ignored, leave no obligation to the issuer under the document labelled letter of credit, the issuer's undertaking is not a letter of credit. It is probably some form of suretyship or other contractual arrangement and may be enforceable as such. See Sections 5-102(a)(10) and 5-103(d). Therefore, undertakings whose fundamental term requires an issuer to look beyond documents and beyond conventional reference to the clock, calendar, and practices concerning the form of various documents are not governed by Article 5. Although Section 5-108(g) recognizes that certain nondocumentary conditions can be included in a letter of credit without denying the undertaking the status of letter of credit, that section does not apply to cases where the nondocumentary condition is fundamental to the issuer's obligation. The rules in Sections 5-102(a)(10), 5-103(d), and 5-108(g) approve the conclusion in *Wichita Eagle & Beacon Publishing Co. v. Pacific Nat. Bank,* 493 F.2d 1285 (9th Cir. 1974).

The adjective "definite" is taken from the UCP. It approves cases that deny letter of credit status to documents that are unduly vague or incomplete. See, e.g., *Transparent Products Corp. v. Paysaver Credit Union,* 864 F.2d 60 (7th Cir. 1988). Note, however, that no particular phrase or label is necessary to establish a letter of credit. It is sufficient if the undertaking of the issuer shows that it is intended to be a letter of credit. In most cases the parties' intention will be indicated by a label on the undertaking itself indicating that it is a "letter of credit" but no such language is necessary.

A financial institution may be both the issuer and the applicant or the issuer and the beneficiary. Such letters are sometimes issued by a bank in support of the bank's own lease obligations or on behalf of one of its

divisions as an applicant or to one of its divisions as beneficiary, such as an overseas branch. Because wide use of letters of credit in which the issuer and the applicant or the issuer and the beneficiary are the same would endanger the unique status of letters of credit, only financial institutions are authorized to issue them.

In almost all cases the ultimate performance of the issuer under a letter of credit is the payment of money. In rare cases the issuer's obligation is to deliver stock certificates or the like. The definition of letter of credit in Section 5-102(a)(10) contemplates those cases.

7. Under the UCP any bank is a nominated bank where the letter of credit is "freely negotiable." A letter of credit might also nominate by the following: "We hereby engage with the drawer, indorsers, and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same will be duly honored on due presentation" or "available with any bank by negotiation." A restricted negotiation credit might be "available with x bank by negotiation" or the like.

Several legal consequences may attach to the status of nominated person. First, when the issuer nominates a person, it is authorizing that person to pay or give value and is authorizing the beneficiary to make presentation to that person. Unless the letter of credit provides otherwise, the beneficiary need not present the documents to the issuer before the letter of credit expires; it need only present those documents to the nominated person. Secondly, a nominated person that gives value in good faith has a right to payment from the issuer despite fraud. Section 5-109(a)(1).

8. A "record" must be in or capable of being converted to a perceivable form. For example, an electronic message recorded in a computer memory that could be printed from that memory could constitute a record. Similarly, a tape recording of an oral conversation could be a record.

9. Absent a specific agreement to the contrary, documents of a beneficiary delivered to an issuer or nominated person are considered to be presented under the letter of credit to which they refer, and any payment or value given for them is considered to be made under that letter of credit. As the court held in *Alaska Textile Co. v. Chase Manhattan Bank, N.A.,* 982 F.2d 813, 820 (2d Cir. 1992), it takes a "significant showing" to make the

presentation of a beneficiary's documents for "collection only" or otherwise outside letter of credit law and practice.

10. Although a successor of a beneficiary is one who succeeds "by operation of law," some of the successions contemplated by Section 5-102(a)(15) will have resulted from voluntary action of the beneficiary such as merger of a corporation. Any merger makes the successor corporation the "successor of a beneficiary" even though the transfer occurs partly by operation of law and partly by the voluntary action of the parties. The definition excludes certain transfers, where no part of the transfer is "by operation of law" — such as the sale of assets by one company to another.

11. "Draft" in Article 5 does not have the same meaning it has in Article 3. For example, a document may be a draft under Article 5 even though it would not be a negotiable instrument, and therefore would not qualify as a draft under Section 3-104(e).

§ 28-5-103. Scope. — (1) This chapter applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(2) The statement of a rule in this chapter does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this chapter.

(3) With the exception of this subsection, subsections (1) and (2), sections 28-5-102(1)(i) and (1)(j), 28-5-106(4) and 28-5-114(4)[, Idaho Code], and except to the extent prohibited in sections 28-1-302 and 28-5-117(4)[, Idaho Code], the effect of this chapter may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this chapter.

(4) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

History.

I.C., § 28-5-103, as added by 1996, ch. 7, § 2, p. 9; am. 2004, ch. 43, § 35, p. 136.

STATUTORY NOTES

Prior Laws.

Former § 28-5-103, which comprised 1967, ch. 161, § 5-103, p. 351, was repealed by S.L. 1996, ch. 7, § 7, effective July 1, 1996.

Compiler’s Notes.

The bracketed insertions in subsection (3) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Sections 5-102(a)(10) and 5-103 are the principal limits on the scope of Article 5. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are "secondary," "accessory," or "suretyship" guarantees. Although the word "guarantee" is sometimes used to describe an independent obligation like that of the issuer of a letter of credit (most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks), in the United States the word "guarantee" is more typically used to describe a suretyship transaction in which the "guarantor" is only secondarily liable and has the right to assert the underlying debtor's defenses. This article does not apply to secondary or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory guarantor's liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 states that the issuer's liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer's refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the continuing vitality that arises from the certainty and speed of payment under letters of credit. To that end, it is important that the law not carry into letter of credit transactions rules that properly apply only to secondary guarantees or to other forms of engagement.

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties.

Particularly with respect to the standards of performance that are set out in Section 5-108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections 1-302 and 5-103(c). See Section 5-116(c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 must normally either adopt the law of a jurisdiction other than a State of the United States or state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of the kind that is invariable under Section 1-102(3). Section 5-103(c) and Comment 1 to Section 5-108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or

committed “gross negligence” is ineffective under Section 5-103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a “substantially” though not “strictly” complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only a nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

3. Parties should generally avoid modifying the definitions in Section 5-102. The effect of such an agreement is almost inevitably unclear. To say that something is a “guarantee” in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a “letter of credit,” the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

4. Section 5-102(2) and (3) of Article 5 are omitted as unneeded; the omission does not change the law.

§ 28-5-104. Formal requirements. — A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in section 28-5-108(5)[, Idaho Code].

History.

I.C., § 28-5-104, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Cross References.

Record defined, § 28-5-102.

Prior Laws.

Former § 28-5-104, which comprised, 1967, ch. 161, § 5-104, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Compiler's Notes.

The bracketed insertion at the end of the section was added by the compiler to conform to the statutory citation style.

Official Comment

Neither Section 5-104 nor the definition of letter of credit in Section 5-102(a)(10) requires inclusion of all the terms that are normally contained in a letter of credit in order for an undertaking to be recognized as a letter of credit under Article 5. For example, a letter of credit will typically specify the amount available, the expiration date, the place where presentation should be made, and the documents that must be presented to entitle a person to honor. Undertakings that have the formalities required by Section 5-104 and meet the conditions specified in Section 5-102(a)(10) will be recognized as letters of credit even though they omit one or more of the items usually contained in a letter of credit.

2. The authentication specified in this section is authentication only of the identity of the issuer, confirmer, or adviser.

An authentication agreement may be by system rule, by standard practice, or by direct agreement between the parties. The reference to practice is intended to incorporate future developments in the UCP and other practice rules as well as those that may arise spontaneously in commercial practice.

3. Many banking transactions, including the issuance of many letters of credit, are now conducted mostly by electronic means. For example, S.W.I.F.T. is currently used to transmit letters of credit from issuing to advising banks. The letter of credit text so transmitted may be printed at the advising bank, stamped "original" and provided to the beneficiary in that form. The printed document may then be used as a way of controlling and recording payments and of recording and authorizing assignments of proceeds or transfers of rights under the letter of credit. Nothing in this section should be construed to conflict with that practice.

To be a record sufficient to serve as a letter of credit or other undertaking under this section, data must have a durability consistent with that function. Because consideration is not required for a binding letter of credit or similar undertaking (Section 5-105) yet those undertakings are to be strictly construed (Section 5-108), parties to a letter of credit transaction are especially dependent on the continued availability of the terms and conditions of the letter of credit or other undertaking. By declining to specify any particular medium in which the letter of credit must be established or communicated, Section 5-104 leaves room for future developments.

§ 28-5-105. Consideration. — Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation.

History.

I.C., § 28-5-105, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-105, which comprised 1967, ch. 161, § 5-105, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Official Comment It is not to be expected that any issuer will issue its letter of credit without some form of remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration was or whether in fact there was any identifiable remuneration in a given case. And it might be difficult for the beneficiary to prove the issuer's remuneration. This section dispenses with this proof and is consistent with the position of Lord Mansfield in *Pillans v. Van Mierop,* 97 Eng. Rep. 1035 (K.B. 1765) in making consideration irrelevant.

§ 28-5-106. Issuance, amendment, cancellation, and duration. — (1) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.

(2) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(3) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one (1) year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(4) A letter of credit that states that it is perpetual expires five (5) years after its stated date of issuance, or if none is stated, after the date on which it is issued.

History.

I.C., § 28-5-106, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Compiler's Notes.

Former § 28-5-106, which comprised, 1967, ch. 161, § 5-106, p. 315, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

CASE NOTES

Decisions Under Prior Law

Delivery and Receipt.

Where letter of credit prepared by bank was never delivered to plaintiff fertilizer company, the fertilizer company could not rely on it. USA

Fertilizer, Inc. v. Idaho First Nat'l Bank, 120 Idaho 271, 815 P.2d 469 (Ct. App. 1991).

Official Comment

1. This section adopts the position taken by several courts, namely that letters of credit that are silent as to revocability are irrevocable. See, e.g., *Weyerhaeuser Co. v. First Nat. Bank,* 27 UCC Rep. Serv. 777 (S.D. Iowa 1979); West Va. Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107 (W.D. Pa. 1976). This is the position of the current UCP (500). Given the usual commercial understanding and purpose of letters of credit, revocable letters of credit offer unhappy possibilities for misleading the parties who deal with them.

2. A person can consent to an amendment by implication. For example, a beneficiary that tenders documents for honor that conform to an amended letter of credit but not to the original letter of credit has probably consented to the amendment. By the same token an applicant that has procured the issuance of a transferable letter of credit has consented to its transfer and to performance under the letter of credit by a person to whom the beneficiary's rights are duly transferred. If some, but not all of the persons involved in a letter of credit transaction consent to performance that does not strictly conform to the original letter of credit, those persons assume the risk that other nonconsenting persons may insist on strict compliance with the original letter of credit. Under subsection (b) those not consenting are not bound. For example, an issuer might agree to amend its letter of credit or honor documents presented after the expiration date in the belief that the applicant has consented or will consent to the amendment or will waive presentation after the original expiration date. If that belief is mistaken, the issuer is bound to the beneficiary by the terms of the letter of credit as amended or waived, even though it may be unable to recover from the applicant.

In general, the rights of a recognized transferee beneficiary cannot be altered without the transferee's consent, but the same is not true of the rights of assignees of proceeds from the beneficiary. When the beneficiary makes a complete transfer of its interest that is effective under the terms for transfer established by the issuer, adviser, or other party controlling

transfers, the beneficiary no longer has an interest in the letter of credit, and the transferee steps into the shoes of the beneficiary as the one with rights under the letter of credit. Section 5-102(a)(3). When there is a partial transfer, both the original beneficiary and the transferee beneficiary have an interest in performance of the letter of credit and each expects that its rights will not be altered by amendment unless it consents.

The assignee of proceeds under a letter of credit from the beneficiary enjoys no such expectation. Notwithstanding an assignee's notice to the issuer of the assignment of proceeds, the assignee is not a person protected by subsection (b). An assignee of proceeds should understand that its rights can be changed or completely extinguished by amendment or cancellation of the letter of credit. An assignee's claim is precarious, for it depends entirely upon the continued existence of the letter of credit and upon the beneficiary's preparation and presentation of documents that would entitle the beneficiary to honor under Section 5-108.

3. The issuer's right to cancel a revocable letter of credit does not free it from a duty to reimburse a nominated person who has honored, accepted, or undertaken a deferred obligation prior to receiving notice of the amendment or cancellation. Compare UCP Article 8.

4. Although all letters of credit should specify the date on which the issuer's engagement expires, the failure to specify an expiration date does not invalidate the letter of credit, or diminish or relieve the obligation of any party with respect to the letter of credit. A letter of credit that may be revoked or terminated at the discretion of the issuer by notice to the beneficiary is not "perpetual."

§ 28-5-107. Confirmer, nominated person, and adviser. — (1) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer.

(2) A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.

(3) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.

(4) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (3) of this section. The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies.

History.

I.C., § 28-5-107, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Cross References.

Adviser defined, § 28-5-102.

Nominated person defined, § 28-5-102.

Confirmer defined, § 28-5-102.

Prior Laws.

Former § 28-5-107, which comprised 1967, ch. 161, § 5-107, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Official Comment

1. A confirmer has the rights and obligations identified in Section 5-108. Accordingly, unless the context otherwise requires, the terms "confirmer" and "confirmation" should be read into this article wherever the terms "issuer" and "letter of credit" appear.

A confirmer that has paid in accordance with the terms and conditions of the letter of credit is entitled to reimbursement by the issuer even if the beneficiary committed fraud (see Section 5-109(a)(1)(ii)) and, in that sense, has greater rights against the issuer than the beneficiary has. To be entitled to reimbursement from the issuer under the typical confirmed letter of credit, the confirmer must submit conforming documents, but the confirmer's presentation to the issuer need not be made before the expiration date of the letter of credit.

A letter of credit confirmation has been analogized to a guarantee of issuer performance, to a parallel letter of credit issued by the confirmer for the account of the issuer or the letter of credit applicant or both, and to a back-to-back letter of credit in which the confirmer is a kind of beneficiary of the original issuer's letter of credit. Like letter of credit undertakings, confirmations are both unique and flexible, so that no one of these analogies is perfect, but unless otherwise indicated in the letter of credit or confirmation, a confirmer should be viewed by the letter of credit issuer and the beneficiary as an issuer of a parallel letter of credit for the account of the original letter of credit issuer. Absent a direct agreement between the applicant and a confirmer, normally the obligations of a confirmer are to the issuer not the applicant, but the applicant might have a right to injunction against a confirmer under Section 5-109 or warranty claim under Section 5-110, and either might have claims against the other under Section 5-117.

2. No one has a duty to advise until that person agrees to be an adviser or undertakes to act in accordance with the instructions of the issuer. Except where there is a prior agreement to serve or where the silence of the adviser would be an acceptance of an offer to contract, a person's failure to respond

to a request to advise a letter of credit does not in and of itself create any liability, nor does it establish a relationship of issuer and adviser between the two. Since there is no duty to advise a letter of credit in the absence of a prior agreement, there can be no duty to advise it timely or at any particular time. When the adviser manifests its agreement to advise by actually doing so (as is normally the case), the adviser cannot have violated any duty to advise in a timely way. This analysis is consistent with the result of *Sound of Market Street v. Continental Bank International,* 819 F.2d 384 (3d Cir. 1987) which held that there is no such duty. This section takes no position on the reasoning of that case, but does not overrule the result. By advising or agreeing to advise a letter of credit, the adviser assumes a duty to the issuer and to the beneficiary accurately to report what it has received from the issuer, but, beyond determining the apparent authenticity of the letter, an adviser has no duty to investigate the accuracy of the message it has received from the issuer. "Checking" the apparent authenticity of the request to advise means only that the prospective adviser must attempt to authenticate the message (e.g., by "testing" the telex that comes from the purported issuer), and if it is unable to authenticate the message must report that fact to the issuer and, if it chooses to advise the message, to the beneficiary. By proper agreement, an adviser may disclaim its obligation under this section.

3. An issuer may issue a letter of credit which the adviser may advise with different terms. The issuer may then believe that it has undertaken a certain engagement, yet the text in the hands of the beneficiary will contain different terms, and the beneficiary would not be entitled to honor if the documents it submitted did not comply with the terms of the letter of credit as originally issued. On the other hand, if the adviser also confirmed the letter of credit, then as a confirmer it will be independently liable on the letter of credit as advised and confirmed. If in that situation the beneficiary's ultimate presentation entitled it to honor under the terms of the confirmation but not under those in the original letter of credit, the confirmer would have to honor but might not be entitled to reimbursement from the issuer.

4. When the issuer nominates another person to "pay," "negotiate," or otherwise to take up the documents and give value, there can be confusion about the legal status of the nominated person. In rare cases the person might actually be an agent of the issuer and its act might be the act of the

issuer itself. In most cases the nominated person is not an agent of the issuer and has no authority to act on the issuer's behalf. Its "nomination" allows the beneficiary to present to it and earns it certain rights to payment under Section 5-109 that others do not enjoy. For example, when an issuer issues a "freely negotiable credit," it contemplates that banks or others might take up documents under that credit and advance value against them, and it is agreeing to pay those persons but only if the presentation to the issuer made by the nominated person complies with the credit. Usually there will be no agreement to pay, negotiate, or to serve in any other capacity by the nominated person, therefore the nominated person will have the right to decline to take the documents. It may return them or agree merely to act as a forwarding agent for the documents but without giving value against them or taking any responsibility for their conformity to the letter of credit.

§ 28-5-108. Issuer's rights and obligations. — (1) Except as otherwise provided in section 28-5-109[, Idaho Code], an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (5) of this section, appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in section 28-5-113[, Idaho Code,] and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(2) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

(a) to honor,

(b) if the letter of credit provides for honor to be completed more than seven (7) business days after presentation, to accept a draft or incur a deferred obligation, or

(c) to give notice to the presenter of discrepancies in the presentation.

(3) Except as otherwise provided in subsection (4) of this section, an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(4) Failure to give the notice specified in subsection (2) of this section or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor fraud or forgery as described in section 28-5-109(1)[, Idaho Code,] or expiration of the letter of credit before presentation.

(5) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(6) An issuer is not responsible for:

(a) the performance or nonperformance of the underlying contract, arrangement, or transaction,

(b) an act or omission of others, or

(c) observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (5) of this section.

(7) If an undertaking constituting a letter of credit under section 28-5-102(1)(j)[, Idaho Code,] contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(8) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(9) An issuer that has honored a presentation as permitted or required by this chapter:

(a) is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds,

(b) takes the documents free of claims of the beneficiary or presenter,

(c) is precluded from asserting a right of recourse on a draft under sections 28-3-414 and 28-3-415[, Idaho Code],

(d) except as otherwise provided in sections 28-5-110 and 28-5-117[, Idaho Code], is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation, and

(e) is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

History.

I.C., § 28-5-108, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-108, which comprised 1967, ch. 161, § 5-108, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Compiler's Notes.

The bracketed insertions throughout the section were added by the compiler to conform to the statutory citation style.

Official Comment

1. This section combines some of the duties previously included in Sections 5-114 and 5-109. Because a confirmer has the rights and duties of an issuer, this section applies equally to a confirmer and an issuer. See Section 5-107(a).

The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant. By requiring that a "presentation" appear strictly to comply, the section requires not only that the documents themselves appear on their face strictly to comply, but also that the other terms of the letter of credit such as those dealing with the time and place of presentation are strictly complied with. Typically, a letter of credit will provide that presentation is timely if made to the issuer, confirmer, or any other nominated person prior to expiration of the letter of credit. Accordingly, a nominated person that has honored a demand or otherwise given value before expiration will have a right to reimbursement from the issuer even though presentation to the issuer is made after the expiration of the letter of credit. Conversely, where the beneficiary negotiates documents to one who is not a nominated person, the beneficiary or that person acting on behalf of the beneficiary must make presentation to a nominated person, confirmer, or issuer prior to the expiration date.

This section does not impose a bifurcated standard under which an issuer's right to reimbursement might be broader than a beneficiary's right to honor. However, the explicit deference to standard practice in Section 5-108(a) and (e) and elsewhere expands issuers' rights of reimbursement where that practice so provides. Also, issuers can and often do contract with their applicants for expanded rights of reimbursement. Where that is done, the beneficiary will have to meet a more stringent standard of compliance as

to the issuer than the issuer will have to meet as to the applicant. Similarly, a nominated person may have reimbursement and other rights against the issuer based on this article, the UCP, bank-to-bank reimbursement rules, or other agreement or undertaking of the issuer. These rights may allow the nominated person to recover from the issuer even when the nominated person would have no right to obtain honor under the letter of credit.

The section adopts strict compliance, rather than the standard that commentators have called "substantial compliance," the standard arguably applied in *Banco Espanol de Credito v. State Street Bank and Trust Company,* 385 F.2d 230 (1st Cir. 1967) and *Flagship Cruises Ltd. v. New England Merchants Nat. Bank,* 569 F.2d 699 (1st Cir. 1978). Strict compliance does not mean slavish conformity to the terms of the letter of credit. For example, standard practice (what issuers do) may recognize certain presentations as complying that an unschooled layman would regard as discrepant. By adopting standard practice as a way of measuring strict compliance, this article indorses the conclusion of the court in *New Braunfels Nat. Bank v. Odiorne,* 780 S.W.2d 313 (Tex. Ct. App. 1989) (beneficiary could collect when draft requested payment on "Letter of credit No. 86-122-5" and letter of Credit specified "Letter of Credit No. 86-122-S" holding strict compliance does not demand oppressive perfectionism). The section also indorses the result in *Tosco Corp. v. Federal Deposit Insurance Corp.,* 723 F.2d 1242 (6th Cir. 1983). The letter of credit in that case called for "drafts Drawn under Bank of Clarksville Letter of Credit Number 105." The draft presented stated "drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105." The court correctly found that despite the change of upper case "L" to a lower case "l" and the use of the word "No." instead of "Number," and despite the addition of the words "Clarksville, Tennessee," the presentation conformed. Similarly a document addressed by a foreign person to General Motors as "Jeneral Motors" would strictly conform in the absence of other defects.

Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury. As with similar rules in Sections 4A-202(c) and 2-302, it is hoped that there will be more consistency in the outcomes and speedier resolution of disputes if the responsibility for determining the nature and scope of standard practice is granted to the court, not to a jury. Granting the court authority to make

these decisions will also encourage the salutary practice of courts' granting summary judgment in circumstances where there are no significant factual disputes. The statute encourages outcomes such as *American Coleman Co. v. Intrawest Bank,* 887 F.2d 1382 (10th Cir. 1989), where summary judgment was granted.

In some circumstances standards may be established between the issuer and the applicant by agreement or by custom that would free the issuer from liability that it might otherwise have. For example, an applicant might agree that the issuer would have no duty whatsoever to examine documents on certain presentations (e.g., those below a certain dollar amount). Where the transaction depended upon the issuer's payment in a very short time period (e.g., on the same day or within a few hours of presentation), the issuer and the applicant might agree to reduce the issuer's responsibility for failure to discover discrepancies. By the same token, an agreement between the applicant and the issuer might permit the issuer to examine documents exclusively by electronic or electro-optical means. Neither those agreements nor others like them explicitly made by issuers and applicants violate the terms of Section 5-108(a) or (b) or Section 5-103(c).

2. Section 5-108(a) balances the need of the issuer for time to examine the documents against the possibility that the examiner (at the urging of the applicant or for fear that it will not be reimbursed) will take excessive time to search for defects. What is a "reasonable time" is not extended to accommodate an issuer's procuring a waiver from the applicant. See Article 14c of the UCP.

Under both the UCC and the UCP the issuer has a reasonable time to honor or give notice. The outside limit of that time is measured in business days under the UCC and in banking days under the UCP, a difference that will rarely be significant. Neither business nor banking days are defined in Article 5, but a court may find useful analogies in Regulation CC, 12 CFR 229.2, in state law outside of the Uniform Commercial Code, and in Article 4.

Examiners must note that the seven-day period is not a safe harbor. The time within which the issuer must give notice is the lesser of a reasonable time or seven business days. Where there are few documents (as, for example, with the mine run standby letter of credit), the reasonable time

would be less than seven days. If more than a reasonable time is consumed in examination, no timely notice is possible. What is a "reasonable time" is to be determined by examining the behavior of those in the business of examining documents, mostly banks. Absent prior agreement of the issuer, one could not expect a bank issuer to examine documents while the beneficiary waited in the lobby if the normal practice was to give the documents to a person who had the opportunity to examine those together with many others in an orderly process. That the applicant has not yet paid the issuer or that the applicant's account with the issuer is insufficient to cover the amount of the draft is not a basis for extension of the time period.

This section does not preclude the issuer from contacting the applicant during its examination; however, the decision to honor rests with the issuer, and it has no duty to seek a waiver from the applicant or to notify the applicant of receipt of the documents. If the issuer dishonors a conforming presentation, the beneficiary will be entitled to the remedies under Section 5-111, irrespective of the applicant's views.

Even though the person to whom presentation is made cannot conduct a reasonable examination of documents within the time after presentation and before the expiration date, presentation establishes the parties' rights. The beneficiary's right to honor or the issuer's right to dishonor arises upon presentation at the place provided in the letter of credit even though it might take the person to whom presentation has been made several days to determine whether honor or dishonor is the proper course. The issuer's time for honor or giving notice of dishonor may be extended or shortened by a term in the letter of credit. The time for the issuer's performance may be otherwise modified or waived in accordance with Section 5-106.

The issuer's time to inspect runs from the time of its "receipt of documents." Documents are considered to be received only when they are received at the place specified for presentation by the issuer or other party to whom presentation is made. "Receipt of documents" when documents of title are presented must be read in light of the definition of "delivery" in Article 1, Section 1-201 and the definition of "presentment" in Section 5-102(a)(12).

Failure of the issuer to act within the time permitted by subsection (b) constitutes dishonor. Because of the preclusion in subsection (c) and the

liability that the issuer may incur under Section 5-111 for wrongful dishonor, the effect of such a silent dishonor may ultimately be the same as though the issuer had honored, i.e., it may owe damages in the amount drawn but unpaid under the letter of credit.

3. The requirement that the issuer send notice of the discrepancies or be precluded from asserting discrepancies is new to Article 5. It is taken from the similar provision in the UCP and is intended to promote certainty and finality.

The section thus substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103. It rejects the reasoning in *Flagship Cruises Ltd. v. New England Merchants' Nat. Bank,* 569 F.2d 699 (1st Cir. 1978) and *Wing On Bank Ltd. v. American Nat. Bank & Trust Co.,* 457 F.2d 328 (5th Cir. 1972) where the issuer was held to be estopped only if the beneficiary relied on the issuer's failure to give notice.

Assume, for example, that the beneficiary presented documents to the issuer shortly before the letter of credit expired, in circumstances in which the beneficiary could not have cured any discrepancy before expiration. Under the reasoning of *Flagship and Wing On,* the beneficiary's inability to cure, even if it had received notice, would absolve the issuer of its failure to give notice. The virtue of the preclusion obligation adopted in this section is that it forecloses litigation about reliance and detriment.

Even though issuers typically give notice of the discrepancy of tardy presentation when presentation is made after the expiration of a credit, they are not required to give that notice and the section permits them to raise late presentation as a defect despite their failure to give that notice.

4. To act within a reasonable time, the issuer must normally give notice without delay after the examining party makes its decision. If the examiner decides to dishonor on the first day, it would be obliged to notify the beneficiary shortly thereafter, perhaps on the same business day. This rule accepts the reasoning in cases such as *Datapoint Corp. v. M & I Bank,* 665 F. Supp. 722 (W.D. Wis. 1987) and *Esso Petroleum Canada, Div. of Imperial Oil, Ltd. v. Security Pacific Bank,* 710 F. Supp. 275 (D. Ore. 1989).

The section deprives the examining party of the right simply to sit on a presentation that is made within seven days of expiration. The section requires the examiner to examine the documents and make a decision and, having made a decision to dishonor, to communicate promptly with the presenter. Nevertheless, a beneficiary who presents documents shortly before the expiration of a letter of credit runs the risk that it will never have the opportunity to cure any discrepancies.

5. Confirmers, other nominated persons, and collecting banks acting for beneficiaries can be presenters and, when so, are entitled to the notice provided in subsection (b). Even nominated persons who have honored or given value against an earlier presentation of the beneficiary and are themselves seeking reimbursement or honor need notice of discrepancies in the hope that they may be able to procure complying documents. The issuer has the obligations imposed by this section whether the issuer's performance is characterized as "reimbursement" of a nominated person or as "honor."

6. In many cases a letter of credit authorizes presentation by the beneficiary to someone other than the issuer. Sometimes that person is identified as a "payor" or "paying bank," or as an "acceptor" or "accepting bank," in other cases as a "negotiating bank," and in other cases there will be no specific designation. The section does not impose any duties on a person other than the issuer or confirmer, however a nominated person or other person may have liability under this article or at common law if it fails to perform an express or implied agreement with the beneficiary.

7. The issuer's obligation to honor runs not only to the beneficiary but also to the applicant. It is possible that an applicant who has made a favorable contract with the beneficiary will be injured by the issuer's wrongful dishonor. Except to the extent that the contract between the issuer and the applicant limits that liability, the issuer will have liability to the applicant for wrongful dishonor under Section 5-111 as a matter of contract law. A good faith extension of the time in Section 5-108(b) by agreement between the issuer and beneficiary binds the applicant even if the applicant is not consulted or does not consent to the extension.

The issuer's obligation to dishonor when there is no apparent compliance with the letter of credit runs only to the applicant. No other party to the

transaction can complain if the applicant waives compliance with terms or conditions of the letter of credit or agrees to a less stringent standard for compliance than that supplied by this article. Except as otherwise agreed with the applicant, an issuer may dishonor a noncomplying presentation despite an applicant's waiver.

Waiver of discrepancies by an issuer or an applicant in one or more presentations does not waive similar discrepancies in a future presentation. Neither the issuer nor the beneficiary can reasonably rely upon honor over past waivers as a basis for concluding that a future defective presentation will justify honor. The reasoning of *Courtaulds of North America Inc. v. North Carolina Nat. Bank,* 528 F.2d 802 (4th Cir. 1975) is accepted and that expressed in *Schweibish v. Pontchartrain State Bank,* 389 So.2d 731 (La. App. 1980) and *Titanium Metals Corp. v. Space Metals, Inc.,* 529 P.2d 431 (Utah 1974) is rejected.

8. The standard practice referred to in subsection (e) includes (i) international practice set forth in or referenced by the Uniform Customs and Practice, (ii) other practice rules published by associations of financial institutions, and (iii) local and regional practice. It is possible that standard practice will vary from one place to another. Where there are conflicting practices, the parties should indicate which practice governs their rights. A practice may be overridden by agreement or course of dealing. See Section 1-205 [1-303](4).

9. The responsibility of the issuer under a letter of credit is to examine documents and to make a prompt decision to honor or dishonor based upon that examination. Nondocumentary conditions have no place in this regime and are better accommodated under contract or suretyship law and practice. In requiring that nondocumentary conditions in letters of credit be ignored as surplusage, Article 5 remains aligned with the UCP (see UCP 500 Article 13c), approves cases like *Pringle-Associated Mortgage Corp. v. Southern National Bank,* 571 F.2d 871, 874 (5th Cir. 1978), and rejects the reasoning in cases such as *Sherwood & Roberts, Inc. v. First Security Bank,* 682 P.2d 149 (Mont. 1984).

Subsection (g) recognizes that letters of credit sometimes contain nondocumentary terms or conditions. Conditions such as a term prohibiting "shipment on vessels more than 15 years old," are to be disregarded and

treated as surplusage. Similarly, a requirement that there be an award by a "duly appointed arbitrator" would not require the issuer to determine whether the arbitrator had been "duly appointed." Likewise a term in a standby letter of credit that provided for differing forms of certification depending upon the particular type of default does not oblige the issuer independently to determine which kind of default has occurred. These conditions must be disregarded by the issuer. Where the nondocumentary conditions are central and fundamental to the issuer's obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 entirely. See Section 5-102(a)(10) and Comment 6 to Section 5-102.

Subsection (g) would not permit the beneficiary or the issuer to disregard terms in the letter of credit such as place, time, and mode of presentation. The rule in subsection (g) is intended to prevent an issuer from deciding or even investigating extrinsic facts, but not from consulting the clock, the calendar, the relevant law and practice, or its own general knowledge of documentation or transactions of the type underlying a particular letter of credit.

Even though nondocumentary conditions must be disregarded in determining compliance of a presentation (and thus in determining the issuer's duty to the beneficiary), an issuer that has promised its applicant that it will honor only on the occurrence of those nondocumentary conditions may have liability to its applicant for disregarding the conditions.

10. Subsection (f) condones an issuer's ignorance of "any usage of a particular trade"; that trade is the trade of the applicant, beneficiary, or others who may be involved in the underlying transaction. The issuer is expected to know usage that is commonly encountered in the course of document examination. For example, an issuer should know the common usage with respect to documents in the maritime shipping trade but would not be expected to understand synonyms used in a particular trade for product descriptions appearing in a letter of credit or an invoice.

11. Where the issuer's performance is the delivery of an item of value other than money, the applicant's reimbursement obligation would be to make the "item of value" available to the issuer.

12. An issuer is entitled to reimbursement from the applicant after honor of a forged or fraudulent drawing if honor was permitted under Section 5-109(a).

13. The last clause of Section 5-108(i)(5) deals with a special case in which the fraud is not committed by the beneficiary, but is committed by a stranger to the transaction who forges the beneficiary's signature. If the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary. This principle is applicable to both electronic and tangible documents.

§ 28-5-109. Fraud and forgery. — (1) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(a) the issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person, and

(b) the issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(2) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(a) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer,

(b) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted,

(c) all of the conditions to entitle a person to the relief under Idaho law have been met, and

(d) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material

fraud and the person demanding honor does not qualify for protection under subsection (1) (a) of this section.

History.

I.C., § 28-5-109, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-109, which comprised, 1967, ch. 161, § 5-109, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Official Comment

1. This recodification makes clear that fraud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant. See *Cromwell v. Commerce & Energy Bank,* 464 So.2d 721 (La. 1985).

Secondly, it makes clear that fraud must be "material." Necessarily courts must decide the breadth and width of "materiality." The use of the word requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction. Assume, for example, that the beneficiary has a contract to deliver 1,000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice showing 1,000 barrels. If two barrels in a 1,000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary's act, though possibly fraudulent, is not materially so and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent. The courts must examine the underlying transaction when there is an allegation of material fraud, for only by examining that transaction can one determine whether a document is fraudulent or the beneficiary has committed fraud and, if so, whether the fraud was material.

Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support

such a right to honor. The section indorses articulations such as those stated in *Intraworld Indus. v. Girard Trust Bank,* 336 A.2d 316 (Pa. 1975), *Roman Ceramics Corp. v. People's Nat. Bank,* 714 F.2d 1207 (3d Cir. 1983), and similar decisions and embraces certain decisions under Section 5-114 that relied upon the phrase "fraud in the transaction." Some of these decisions have been summarized as follows in *Ground Air Transfer v. Westate's Airlines,* 899 F.2d 1269, 1272-73 (1st Cir. 1990):

> We have said throughout that courts may not "*normally*" issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also explained in Itek, 730 F.2d at 24-25, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "*plainly*" show that the underlying contract forbids the beneficiary to call a letter of credit, Itek, 730 F.2d at 24; where they show that the contract deprives the beneficiary of even a "*colorable*" right to do so, id., at 25; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact," id.; see Dynamics Corp. of America, 356 F. Supp. at 999; where the beneficiary's conduct has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served," Itek, 730 F.2d at 25 (quoting *Roman Ceramics Corp. v. Peoples National Bank,* 714 F.2d 1207, 1212 n.12, 1215 (3d Cir. 1983) (quoting Intraworld Indus., 336 A.2d at 324-25)); *then* a court may enjoin payment.

2. Subsection (a)(2) makes clear that the issuer may honor in the face of the applicant's claim of fraud. The subsection also makes clear what was not stated in former Section 5-114, that the issuer may dishonor and defend that dishonor by showing fraud or forgery of the kind stated in subsection (a). Because issuers may be liable for wrongful dishonor if they are unable to prove forgery or material fraud, presumably most issuers will choose to honor despite applicant's claims of fraud or forgery unless the applicant procures an injunction. Merely because the issuer has a right to dishonor and to defend that dishonor by showing forgery or material fraud does not mean it has a duty to the applicant to dishonor. The applicant's normal recourse is to procure an injunction, if the applicant is unable to procure an

injunction, it will have a claim against the issuer only in the rare case in which it can show that the issuer did not honor in good faith.

3. Whether a beneficiary can commit fraud by presenting a draft under a clean letter of credit (one calling only for a draft and no other documents) has been much debated. Under the current formulation it would be possible but difficult for there to be fraud in such a presentation. If the applicant were able to show that the beneficiary were committing material fraud on the applicant in the underlying transaction, then payment would facilitate a material fraud by the beneficiary on the applicant and honor could be enjoined. The courts should be skeptical of claims of fraud by one who has signed a "suicide" or clean credit and thus granted a beneficiary the right to draw by mere presentation of a draft.

4. The standard for injunctive relief is high, and the burden remains on the applicant to show, by evidence and not by mere allegation, that such relief is warranted. Some courts have enjoined payments on letters of credit on insufficient showing by the applicant. For example, in *Griffin Cos. v. First Nat. Bank,* 374 N.W.2d 768 (Minn. App. 1985), the court enjoined payment under a standby letter of credit, basing its decision on plaintiff's allegation, rather than competent evidence, of fraud.

There are at least two ways to prohibit injunctions against honor under this section after acceptance of a draft by the issuer. First is to define honor (see Section 5-102(a)(8)) in the particular letter of credit to occur upon acceptance and without regard to later payment of the acceptance. Second is explicitly to agree that the applicant has no right to an injunction after acceptance — whether or not the acceptance constitutes honor.

5. Although the statute deals principally with injunctions against honor, it also cautions against granting "similar relief" and the same principles apply when the applicant or issuer attempts to achieve the same legal outcome by injunction against presentation (see *Ground Air Transfer Inc. v. Westates Airlines, Inc.,* 899 F.2d 1269 (1st Cir. 1990)), interpleader, declaratory judgment, or attachment. These attempts should face the same obstacles that face efforts to enjoin the issuer from paying. Expanded use of any of these devices could threaten the independence principle just as much as injunctions against honor. For that reason courts should have the same hostility to them and place the same restrictions on their use as would be

applied to injunctions against honor. Courts should not allow the "sacred cow of equity to trample the tender vines of letter of credit law."

6. Section 5-109(a)(1) also protects specified third parties against the risk of fraud. By issuing a letter of credit that nominates a person to negotiate or pay, the issuer (ultimately the applicant) induces that nominated person to give value and thereby assumes the risk that a draft drawn under the letter of credit will be transferred to one with a status like that of a holder in due course who deserves to be protected against a fraud defense.

7. The "loss" to be protected against — by bond or otherwise under subsection (b)(2) — includes incidental damages. Among those are legal fees that might be incurred by the beneficiary or issuer in defending against an injunction action.

§ 28-5-110. Warranties. — (1) If its presentation is honored, the beneficiary warrants:

(a) to the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in section 28-5-109(1)[, Idaho Code]; and

(b) to the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(2) The warranties in subsection (1) of this section are in addition to warranties arising under chapters 3, 4, 7 and 8, title 28, Idaho Code, because of the presentation or transfer of documents covered by any of those chapters.

History.

I.C., § 28-5-110, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-110, which comprised, 1967, ch. 161, § 5-110, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Compiler's Notes.

The bracketed insertion at the end of paragraph (1)(a) was added by the compiler to conform to the statutory citation style.

Official Comment

1. Since the warranties in subsection (a) are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by the issuer. Any defense must be based on Section 5-108 or 5-109 and not on this section. Also, breach of the warranties by the beneficiary in subsection (a) cannot excuse the applicant's duty to reimburse.

2. The warranty in Section 5-110(a)(2) assumes that payment under the letter of credit is final. It does not run to the issuer, only to the applicant. In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. It is not a warranty that the statements made on the presentation of the documents presented are truthful nor is it a warranty that the documents strictly comply under Section 5-108(a). It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. If, for example, an underlying sales contract authorized the beneficiary to draw only upon "due performance" and the beneficiary drew even though it had breached the underlying contract by delivering defective goods, honor of its draw would break the warranty. By the same token, if the underlying contract authorized the beneficiary to draw only upon actual default or upon its or a third party's determination of default by the applicant and if the beneficiary drew in violation of its authorization, then upon honor of its draw the warranty would be breached. In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), but the breach of warranty arises not because the statements are untrue but because the beneficiary's drawing violated its express or implied obligations in the underlying transaction.

3. The damages for breach of warranty are not specified in Section 5-111. Courts may find damage analogies in Section 2-714 in Article 2 and in warranty decisions under Articles 3 and 4.

Unlike wrongful dishonor cases — where the damages usually equal the amount of the draw — the damages for breach of warranty will often be much less than the amount of the draw, sometimes zero. Assume a seller entitled to draw only on proper performance of its sales contract. Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant's damages for breach of the warranty in subsection (a)(2) are limited to the damages it could recover for breach of the contract of sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the "amount in default." Assume a

default of $ 200,000 and a draw of $ 500,000. The damages for breach of warranty would be no more than $ 300,000.

§ 28-5-111. Remedies. — (1) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(2) If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(3) If an adviser or nominated person other than a confirmer breaches an obligation under this article or an issuer breaches an obligation not covered in subsection (1) or (2) of this section, a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection and subsections (1) and (2) of this section.

(4) An issuer, nominated person, or adviser who is found liable under subsection (1), (2) or (3) of this section shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(5) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought

under this chapter.

(6) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

History.

I.C., § 28-5-111, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-111, which comprised 1967, ch. 161, § 5-111, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Official Comment

1. The right to specific performance is new. The express limitation on the duty of the beneficiary to mitigate damages adopts the position of certain courts and commentators. Because the letter of credit depends upon speed and certainty of payment, it is important that the issuer not be given an incentive to dishonor. The issuer might have an incentive to dishonor if it could rely on the burden of mitigation falling on the beneficiary, (to sell goods and sue only for the difference between the price of the goods sold and the amount due under the letter of credit). Under the scheme contemplated by Section 5-111(a), the beneficiary would present the documents to the issuer. If the issuer wrongfully dishonored, the beneficiary would have no further duty to the issuer with respect to the goods covered by documents that the issuer dishonored and returned. The issuer thus takes the risk that the beneficiary will let the goods rot or be destroyed. Of course the beneficiary may have a duty of mitigation to the applicant arising from the underlying agreement, but the issuer would not have the right to assert that duty by way of defense or setoff. See Section 5-117(d). If the beneficiary sells the goods covered by dishonored documents or if the beneficiary sells a draft after acceptance but before dishonor by the issuer, the net amount so gained should be subtracted from the amount of the beneficiary's damages — at least where the damage claim against the issuer

equals or exceeds the damage suffered by the beneficiary. If, on the other hand, the beneficiary suffers damages in an underlying transaction in an amount that exceeds the amount of the wrongfully dishonored demand (e.g., where the letter of credit does not cover 100 percent of the underlying obligation), the damages avoided should not necessarily be deducted from the beneficiary's claim against the issuer. In such a case, the damages would be the lesser of (i) the amount recoverable in the absence of mitigation (that is, the amount that is subject to the dishonor or repudiation plus any incidental damages) and (ii) the damages remaining after deduction for the amount of damages actually avoided.

A beneficiary need not present documents as a condition of suit for anticipatory repudiation, but if a beneficiary could never have obtained documents necessary for a presentation conforming to the letter of credit, the beneficiary cannot recover for anticipatory repudiation of the letter of credit. *Doelger v. Battery Park Bank,* 201 A.D. 515, 194 N.Y.S. 582 (1922) and *Decor by Nikkei Int'l, Inc. v. Federal Republic of Nigeria,* 497 F. Supp. 893 (S.D.N.Y. 1980), *aff'd,* 647 F.2d 300 (2d Cir. 1981), *cert. denied,* 454 U.S. 1148 (1982). The last sentence of subsection (c) does not expand the liability of a confirmer to persons to whom the confirmer would not otherwise be liable under Section 5-107.

Almost all letters of credit, including those that call for an acceptance, are "obligations to pay money" as that term is used in Section 5-111(a).

2. What damages "result" from improper honor is for the courts to decide. Even though an issuer pays a beneficiary in violation of Section 5-108(a) or of its contract with the applicant, it may have no liability to an applicant. If the underlying contract has been fully performed, the applicant may not have been damaged by the issuer's breach. Such a case would occur when *A* contracts for goods at $ 100 per ton, but, upon delivery, the market value of conforming goods has decreased to $ 25 per ton. If the issuer pays over discrepancies, there should be no recovery by *A* for the price differential if the issuer's breach did not alter the applicant's obligation under the underlying contract, i.e., to pay $ 100 per ton for goods now worth $ 25 per ton. On the other hand, if the applicant intends to resell the goods and must itself satisfy the strict compliance requirements under a second letter of credit in connection with its sale, the applicant may be damaged by the issuer's payment despite discrepancies because the

applicant itself may then be unable to procure honor on the letter of credit where it is the beneficiary, and may be unable to mitigate its damages by enforcing its rights against others in the underlying transaction. Note that an issuer found liable to its applicant may have recourse under Section 5-117 by subrogation to the applicant's claim against the beneficiary or other persons.

One who inaccurately advises a letter of credit breaches its obligation to the beneficiary, but may cause no damage. If the beneficiary knows the terms of the letter of credit and understands the advice to be inaccurate, the beneficiary will have suffered no damage as a result of the adviser's breach.

3. Since the confirmer has the rights and duties of an issuer, in general it has an issuer's liability, see subsection (c). The confirmer is usually a confirming bank. A confirming bank often also plays the role of an adviser. If it breaks its obligation to the beneficiary, the confirming bank may have liability as an issuer or, depending upon the obligation that was broken, as an adviser. For example, a wrongful dishonor would give it liability as an issuer under Section 5-111(a). On the other hand a confirming bank that broke its obligation to advise the credit but did not commit wrongful dishonor would be treated under Section 5-111(c).

4. Consequential damages for breach of obligations under this article are excluded in the belief that these damages can best be avoided by the beneficiary or the applicant and out of the fear that imposing consequential damages on issuers would raise the cost of the letter of credit to a level that might render it uneconomic. A *fortiori* punitive and exemplary damages are excluded, however, this section does not bar recovery of consequential or even punitive damages for breach of statutory or common law duties arising outside of this article.

5. The section does not specify a rate of interest. It leaves the setting of the rate to the court. It would be appropriate for a court to use the rate that would normally apply in that court in other situations where interest is imposed by law.

6. The court must award attorney's fees to the prevailing party, whether that party is an applicant, a beneficiary, an issuer, a nominated person, or adviser. Since the issuer may be entitled to recover its legal fees and costs from the applicant under the reimbursement agreement, allowing the issuer

to recover those fees from a losing beneficiary may also protect the applicant against undeserved losses. The party entitled to attorneys' fees has been described as the "prevailing party." Sometimes it will be unclear which party "prevailed," for example, where there are multiple issues and one party wins on some and the other party wins on others. Determining which is the prevailing party is in the discretion of the court. Subsection (e) authorizes attorney's fees in all actions where a remedy is sought "under this article." It applies even when the remedy might be an injunction under Section 5-109 or when the claimed remedy is otherwise outside of Section 5-111. Neither an issuer nor a confirmer should be treated as a "losing" party when an injunction is granted to the applicant over the objection of the issuer or confirmer; accordingly neither should be liable for fees and expenses in that case.

"Expenses of litigation" is intended to be broader than "costs." For example, expense of litigation would include travel expenses of witnesses, fees for expert witnesses, and expenses associated with taking depositions.

7. For the purposes of Section 5-111(f) "harm anticipated" must be anticipated at the time when the agreement that includes the liquidated damage clause is executed or at the time when the undertaking that includes the clause is issued. See Section 2A-504.

§ 28-5-112. Transfer of letter of credit. — (1) Except as otherwise provided in section 28-5-113[, Idaho Code], unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(2) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(a) the transfer would violate applicable law, or

(b) the transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer which is within the standard practice referred to in section 28-5-108(5)[, Idaho Code,] or is otherwise reasonable under the circumstances.

History.

I.C., § 28-5-112, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-112, which comprised 1967, ch. 161, § 5-112, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Compiler's Notes.

The bracketed insertions in subsection (1) and paragraph (2)(b) were added by the compiler to conform to the statutory citation style.

Official Comment

1. In order to protect the applicant's reliance on the designated beneficiary, letter of credit law traditionally has forbidden the beneficiary to convey to third parties its right to draw or demand payment under the letter of credit. Subsection (a) codifies that rule. The term "transfer" refers to the beneficiary's conveyance of that right. Absent incorporation of the UCP

(which make elaborate provision for partial transfer of a commercial letter of credit) or similar trade practice and absent other express indication in the letter of credit that the term is used to mean something else, a term in the letter of credit indicating that the beneficiary has the right to transfer should be taken to mean that the beneficiary may convey to a third party its right to draw or demand payment. Even in that case, the issuer or other person controlling the transfer may make the beneficiary's right to transfer subject to conditions, such as timely notification, payment of a fee, delivery of the letter of credit to the issuer or other person controlling the transfer, or execution of appropriate forms to document the transfer. A nominated person who is not a confirmer has no obligation to recognize a transfer.

The power to establish "requirements" does not include the right absolutely to refuse to recognize transfers under a transferable letter of credit. An issuer who wishes to retain the right to deny all transfers should not issue transferable letters of credit or should incorporate the UCP. By stating its requirements in the letter of credit an issuer may impose any requirement without regard to its conformity to practice or reasonableness. Transfer requirements of issuers and nominated persons must be made known to potential transferors and transferees to enable those parties to comply with the requirements. A common method of making such requirements known is to use a form that indicates the information that must be provided and the instructions that must be given to enable the issuer or nominated person to comply with a request to transfer.

2. The issuance of a transferable letter of credit with the concurrence of the applicant is ipso facto an agreement by the issuer and applicant to permit a beneficiary to transfer its drawing right and permit a nominated person to recognize and carry out that transfer without further notice to them. In international commerce, transferable letters of credit are often issued under circumstances in which a nominated person or adviser is expected to facilitate the transfer from the original beneficiary to a transferee and to deal with that transferee. In those circumstances it is the responsibility of the nominated person or adviser to establish procedures satisfactory to protect itself against double presentation or dispute about the right to draw under the letter of credit. Commonly such a person will control the transfer by requiring that the original letter of credit be given to it or by causing a paper copy marked as an original to be issued where the

original letter of credit was electronic. By keeping possession of the original letter of credit the nominated person or adviser can minimize or entirely exclude the possibility that the original beneficiary could properly procure payment from another bank. If the letter of credit requires presentation of the original letter of credit itself, no other payment could be procured. In addition to imposing whatever requirements it considers appropriate to protect itself against double payment the person that is facilitating the transfer has a right to charge an appropriate fee for its activity.

"Transfer" of a letter of credit should be distinguished from "assignment of proceeds." The former is analogous to a novation or a substitution of beneficiaries. It contemplates not merely payment to but also performance by the transferee. For example, under the typical terms of transfer for a commercial letter of credit, a transferee could comply with a letter of credit transferred to it by signing and presenting its own draft and invoice. An assignee of proceeds, on the other hand, is wholly dependent on the presentation of a draft and invoice signed by the beneficiary.

By agreeing to the issuance of a transferable letter of credit, which is not qualified or limited, the applicant may lose control over the identity of the person whose performance will earn payment under the letter of credit.

§ 28-5-113. Transfer by operation of law. — (1) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(2) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (5) of this section, an issuer shall recognize a disclosed successor of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in section 28-5-108(5)[, Idaho Code,] or, in the absence of such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(3) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(4) Honor of a purported successor's apparently complying presentation under subsection (1) or (2) of this section has the consequences specified in section 28-5-108(9)[, Idaho Code,] even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of section 28-5-109[, Idaho Code].

(5) An issuer whose rights of reimbursement are not covered by subsection (4) of this section or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under subsection (2) of this section.

(6) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

History.

I.C., § 28-5-113, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-113, which comprised S.L. 1967, ch. 161, § 5-113, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Compiler's Notes.

The bracketed insertions in subsections (2) and (4) were added by the compiler to conform to the statutory citation style.

Official Comment

This section affirms the result in *Pastor v. Nat. Republic Bank of Chicago,* 76 Ill. 2d 139, 390 N.E.2d 894 (Ill. 1979) and *Federal Deposit Insurance Co. v. Bank of Boulder,* 911 F.2d 1466 (10th Cir. 1990). Both electronic and tangible documents may be signed.

An issuer's requirements for recognition of a successor's status might include presentation of a certificate of merger, a court order appointing a bankruptcy trustee or receiver, a certificate of appointment as bankruptcy trustee, or the like. The issuer is entitled to rely upon such documents which on their face demonstrate that presentation is made by a successor of a beneficiary. It is not obliged to make an independent investigation to determine the fact of succession.

§ 28-5-114. Assignment of proceeds. — (1) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(2) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(3) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(4) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(5) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(6) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by chapter 9, title 28, Idaho Code, or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by chapter 9, title 28, Idaho Code, or other law.

History.

I.C., § 28-5-114, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-114, which comprised S.L. 1967, ch. 161, § 5-114; am. 1995, ch. 272, § 19, p. 873, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Official Comment

1. Subsection (b) expressly validates the beneficiary's present assignment of letter of credit proceeds if made after the credit is established but before the proceeds are realized. This section adopts the prevailing usage — "assignment of proceeds" — to an assignee. That terminology carries with it no implication, however, that an assignee acquires no interest until the proceeds are paid by the issuer. For example, an "assignment of the right to proceeds" of a letter of credit for purposes of security that meets the requirements of Section 9-203(1) would constitute the present creation of a security interest in that right. This security interest can be perfected by possession (Section 9-305) if the letter of credit is in written form. Although subsection (a) explains the meaning of "'proceeds' of a letter of credit," it should be emphasized that those proceeds also may be Article 9 proceeds of other collateral. For example, if a seller of inventory receives a letter of credit to support the account that arises upon the sale, payments made under the letter of credit are Article 9 proceeds of the inventory, account, and any document of title covering the inventory. Thus, the secured party who had a perfected security interest in that inventory, account, or document has a perfected security interest in the proceeds collected under the letter of credit, so long as they are identifiable cash proceeds (Section 9-306(2), (3)). This perfection is continuous, regardless of whether the secured party perfected a security interest in the right to letter of credit proceeds.

2. An assignee's rights to enforce an assignment of proceeds against an issuer and the priority of the assignee's rights against a nominated person or transferee beneficiary are governed by Article 5. Those rights and that priority are stated in subsections (c), (d), and (e). Note also that Section 4-210 gives first priority to a collecting bank that has given value for a documentary draft.

3. By requiring that an issuer or nominated person consent to the assignment of proceeds of a letter of credit, subsections (c) and (d) follow more closely recognized national and international letter of credit practices than did prior law. In most circumstances, it has always been advisable for the assignee to obtain the consent of the issuer in order better to safeguard its right to the proceeds. When notice of an assignment has been received, issuers normally have required signatures on a consent form. This practice is reflected in the revision. By unconditionally consenting to such an assignment, the issuer or nominated person becomes bound, subject to the rights of the superior parties specified in subsection (e), to pay to the assignee the assigned letter of credit proceeds that the issuer or nominated person would otherwise pay to the beneficiary or another assignee.

Where the letter of credit must be presented as a condition to honor and the assignee holds and exhibits the letter of credit to the issuer or nominated person, the risk to the issuer or nominated person of having to pay twice is minimized. In such a situation, subsection (d) provides that the issuer or nominated person may not unreasonably withhold its consent to the assignment.

§ 28-5-115. Statute of limitations. — An action to enforce a right or obligation arising under this chapter must be commenced within one (1) year after the expiration date of the relevant letter of credit or one (1) year after the cause of action accrues, whichever occurs later. A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

History.

I.C., § 28-5-115, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-115 which comprised, S.L. 1967, ch. 161, § 5-115, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Official Comment 1. This section is based upon Sections 4-111 and 2-725(2).

2. This section applies to all claims for which there are remedies under Section 5-111 and to other claims made under this article, such as claims for breach of warranty under Section 5-110. Because it covers all claims under Section 5-111, the statute of limitations applies not only to wrongful dishonor claims against the issuer but also to claims between the issuer and the applicant arising from the reimbursement agreement. These might be for reimbursement (issuer v. applicant) or for breach of the reimbursement contract by wrongful honor (applicant v. issuer).

3. The statute of limitations, like the rest of the statute, applies only to a letter of credit issued on or after the effective date and only to transactions, events, obligations, or duties arising out of or associated with such a letter. If a letter of credit was issued before the effective date and an obligation on that letter of credit was breached after the effective date, the complaining party could bring its suit within the time that would have been permitted

prior to the adoption of Section 5-115 and would not be limited by the terms of Section 5-115.

§ 28-5-116. Choice of law and forum. — (1) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in section 28-5-104[, Idaho Code,] or by a provision in the person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(2) Unless subsection (1) of this section applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address indicated in the person's undertaking. If more than one (1) address is indicated, the person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(3) Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the uniform customs and practice for documentary credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this chapter would govern the liability of an issuer, nominated person, or adviser under subsection (1) or (2) of this section, (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this chapter and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in section 28-5-103(3)[, Idaho Code].

(4) If there is conflict between this chapter and chapter 3, 4, or 9, title 28, Idaho Code, this chapter governs.

(5) The forum for settling disputes arising out of an undertaking within this chapter may be chosen in the manner and with the binding effect that

governing law may be chosen in accordance with subsection (1) of this section.

History.

I.C., § 28-5-116, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-116, which comprised S.L. 1967, ch. 161, § 5-116, p. 351; am. 1979, ch. 299. § 3, p. 781, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Compiler's Notes.

The bracketed insertions in subsections (1) and (3) were added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Idaho Law Review. — Choice of Law in Idaho: A Survey and Critique of Idaho Cases, Andrew S. Jorgensen. 49 Idaho L. Rev. 547 (2013).

Official Comment

1. Although it would be possible for the parties to agree otherwise, the law normally chosen by agreement under subsection (a) and that provided in the absence of agreement under subsection (b) is the substantive law of a particular jurisdiction not including the choice of law principles of that jurisdiction. Thus, two parties, an issuer and an applicant, both located in Oklahoma might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law. By the same token, the liability of an issuer located in New York is governed by New York substantive law — in the absence of agreement — even in circumstances in which choice of law principles found in the common law of New York might direct one to the law of another State. Subsection (b) states the relevant choice of law principles and it should not be subordinated to some

other choice of law rule. Within the States of the United States *renvoi* will not be a problem once every jurisdiction has enacted Section 5-116 because every jurisdiction will then have the same choice of law rule and in a particular case all choice of law rules will point to the same substantive law.

Subsection (b) does not state a choice of law rule for the "liability of an applicant." However, subsection (b) does state a choice of law rule for the liability of an issuer, nominated person, or adviser, and since some of the issues in suits by applicants against those persons involve the "liability of an issuer, nominated person, or adviser," subsection (b) states the choice of law rule for those issues. Because an issuer may have liability to a confirmer both as an issuer (Section 5-108(a), Comment 5 to Section 5-108) and as an applicant (Section 5-107(a), Comment 1 to Section 5-107, Section 5-108(i)), subsection (b) may state the choice of law rule for some but not all of the issuer's liability in a suit by a confirmer.

2. Because the confirmer or other nominated person may choose different law from that chosen by the issuer or may be located in a different jurisdiction and fail to choose law, it is possible that a confirmer or nominated person may be obligated to pay (under their law) but will not be entitled to payment from the issuer (under its law). Similarly, the rights of an unreimbursed issuer, confirmer, or nominated person against a beneficiary under Section 5-109, 5-110, or 5-117, will not necessarily be governed by the same law that applies to the issuer's or confirmer's obligation upon presentation. Because the UCP and other practice are incorporated in most international letters of credit, disputes arising from different legal obligations to honor have not been frequent. Since Section 5-108 incorporates standard practice, these problems should be further minimized — at least to the extent that the same practice is and continues to be widely followed.

3. This section does not permit what is now authorized by the nonuniform Section 5-102(4) in New York. Under the current law in New York a letter of credit that incorporates the UCP is not governed in any respect by Article 5. Under revised Section 5-116 letters of credit that incorporate the UCP or similar practice will still be subject to Article 5 in certain respects. First, incorporation of the UCP or other practice does not override the nonvariable terms of Article 5. Second, where there is no conflict between Article 5 and the relevant provision of the UCP or other

practice, both apply. Third, practice provisions incorporated in a letter of credit will not be effective if they fail to comply with Section 5-103(c). Assume, for example, that a practice provision purported to free a party from any liability unless it were "grossly negligent" or that the practice generally limited the remedies that one party might have against another. Depending upon the circumstances, that disclaimer or limitation of liability might be ineffective because of Section 5-103(c).

Even though Article 5 is generally consistent with UCP 500, it is not necessarily consistent with other rules or with versions of the UCP that may be adopted after Article 5's revision, or with other practices that may develop. Rules of practice incorporated in the letter of credit or other undertaking are those in effect when the letter of credit or other undertaking is issued. Except in the unusual cases discussed in the immediately preceding paragraph, practice adopted in a letter of credit will override the rules of Article 5 and the parties to letter of credit transactions must be familiar with practice (such as future versions of the UCP) that is explicitly adopted in letters of credit.

4. In several ways Article 5 conflicts with and overrides similar matters governed by Articles 3 and 4. For example, "draft" is more broadly defined in letter of credit practice than under Section 3-104. The time allowed for honor and the required notification of reasons for dishonor are different in letter of credit practice than in the handling of documentary and other drafts under Articles 3 and 4.

5. Subsection (e) must be read in conjunction with existing law governing subject matter jurisdiction. If the local law restricts a court to certain subject matter jurisdiction not including letter of credit disputes, subsection (e) does not authorize parties to choose that forum. For example, the parties' agreement under Section 5-116(e) would not confer jurisdiction on a probate court to decide a letter of credit case.

If the parties choose a forum under subsection (e) and if — because of other law — that forum will not take jurisdiction, the parties' agreement or undertaking should then be construed (for the purpose of forum selection) as though it did not contain a clause choosing a particular forum. That result is necessary to avoid sentencing the parties to eternal purgatory where neither the chosen State nor the State which would have jurisdiction but for

the clause will take jurisdiction — the former in disregard of the clause and the latter in honor of the clause.

§ 28-5-117. Subrogation of issuer, applicant, and nominated person. —

(1) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(2) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (1) of this section.

(3) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(a) the issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant,

(b) the beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary, and

(c) the applicant to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(4) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (1) and (2) of this section do not arise until the issuer honors the letter of credit or otherwise pays and the rights in subsection (3) of this section do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse.

History.

I.C., § 28-5-117, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Prior Laws.

Former § 28-5-117, which comprised S.L. 1967, ch. 351, § 5-117, p. 351, was repealed by S.L. 1996, ch. 7, § 1, effective July 1, 1996.

Official Comment

1. By itself this section does not grant any right of subrogation. It grants only the right that would exist if the person seeking subrogation "were a secondary obligor." (The term "secondary obligor" refers to a surety, guarantor, or other person against whom or whose property an obligee has recourse with respect to the obligation of a third party. See Restatement of the Law Third, Suretyship § 1 (1995).) If the secondary obligor would not have a right to subrogation in the circumstances in which one is claimed under this section, none is granted by this section. In effect, the section does no more than to remove an impediment that some courts have found to subrogation because they conclude that the issuer's or other claimant's rights are "independent" of the underlying obligation. If, for example, a secondary obligor would not have a subrogation right because its payment did not fully satisfy the underlying obligation, none would be available under this section. The section indorses the position of Judge Becker in *Tudor Development Group, Inc. v. United States Fidelity and Guaranty,* 968 F.2d 357 (3rd Cir. 1991).

2. To preserve the independence of the letter of credit obligation and to insure that subrogation not be used as an offensive weapon by an issuer or others, the admonition in subsection (d) must be carefully observed. Only one who has completed its performance in a letter of credit transaction can have a right to subrogation. For example, an issuer may not dishonor and then defend its dishonor or assert a setoff on the ground that it is subrogated to another person's rights. Nor may the issuer complain after honor that its subrogation rights have been impaired by any good faith dealings between the beneficiary and the applicant or any other person. Assume, for example, that the beneficiary under a standby letter of credit is a mortgagee. If the mortgagee were obliged to issue a release of the mortgage upon payment of the underlying debt (by the issuer under the letter of credit), that release

might impair the issuer's rights of subrogation, but the beneficiary would have no liability to the issuer for having granted that release.

§ 28-5-118. Applicability. — This act applies to a letter of credit that is issued on or after the effective date of this act. This act does not apply to a transaction, event, obligation, or duty arising out of or associated with a letter of credit that was issued before the effective date of this act.

History.

I.C., § 28-5-118, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Compiler's Notes.

The term "this act" in this section refers to S.L. 1996, ch. 7 which is compiled as §§ 28-1-301, 28-2-512, and 28-5-101 to 28-5-119.

The phrase "the effective date of this act" refers to the effective date of S.L. 1996, ch. 7, which was July 1, 1996.

§ 28-5-119. Savings clause. — A transaction arising out of or associated with a letter of credit that was issued before the effective date of this act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.

History.

I.C., § 28-5-119, as added by 1996, ch. 7, § 2, p. 9.

STATUTORY NOTES

Compiler's Notes.

The term "this act" in this section refers to S.L. 1996, ch. 7 which is compiled as §§ 28-1-301, 28-2-512, and 28-5-101 to 28-5-119.

The phrase "the effective date of this act" refers to the effective date of S.L. 1996, ch. 7, which was July 1, 1996.

§ 28-5-120. Security interest of issuer or nominated person. — (a) An issuer or nominated person has a security interest in a document presented under a letter of credit to the extent that the issuer or nominated person honors or gives value for the presentation.

(b) So long as and to the extent that an issuer or nominated person has not been reimbursed or has not otherwise recovered the value given with respect to a security interest in a document under subsection (a) of this section, the security interest continues and is subject to chapter 9, title 28, Idaho Code, but:

(1) A security agreement is not necessary to make the security interest enforceable under section 28-9-203(b)(3), Idaho Code;

(2) If the document is presented in a medium other than a written or other tangible medium, the security interest is perfected; and

(3) If the document is presented in a written or other tangible medium and is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, the security interest is perfected and has priority over a conflicting security interest in the document so long as the debtor does not have possession of the document. This act applies to a letter of credit that is issued on or after the effective date of this act. This act does not apply to a transaction, event, obligation, or duty arising out of or associated with a letter of credit that was issued before the effective date of this act.

History.

I.C., § 28-5-120, as added by 2001, ch. 208, § 11, p. 704; am. 2014, ch. 97, § 9, p. 265.

STATUTORY NOTES

Amendments.

The 2014 amendment, by ch. 97, added “Idaho Code” in paragraph (b)(1).

Compiler's Notes.

The term "this act" in the last paragraph refers to S.L. 2001, ch. 208, which revised Article (Chapter) 9 of the Uniform Commercial Code and amended many other sections of the Idaho Code to conform to that revision.

The phrase "effective date of this act" in the last paragraph refers to the effective date of S.L. 2001, ch. 208, which was effective July 1, 2001.

Official Comment

1. This section gives the issuer of a letter of credit or a nominated person thereunder an automatic perfected security interest in a "document"(as that term is defined in Section 5-102(a)(6)). The security interest arises only if the document is presented to the issuer or nominated person under the letter of credit and only to the extent of the value that is given. This security interest is analogous to that awarded to a collecting bank under Section 4-210. Subsection (b) contains special rules governing the security interest arising under this section. In all other respects, a security interest arising under this section is subject to Article 9. See Section 9-109. Thus, for example, a security interest arising under this section may give rise to a security interest in proceeds under Section 9-315.

2. Subsection (b)(1) makes a security agreement unnecessary to the creation of a security interest under this section. Under subsection (b)(2), a security interest arising under this section is perfected if the document is presented in a medium other than a written or tangible medium. Documents that are written and that are not an otherwise-defined type of collateral under Article 9 (e.g., an invoice or inspection certificate) may be goods, in which an issuer or nominated person could perfect its security interest by possession. Because the definition of document in Section 5-102(a)(6) includes records (e.g., electronic records) that may not be goods, subsection (b)(2) provides for automatic perfection (i.e., without filing or possession).

Under subsection (b)(3), if the document (i) is in a written or tangible medium, (ii) is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, and (iii) is not in the debtor's possession, the security interest is perfected and has priority over a conflicting security interest. If the document is a type of tangible collateral that subsection (b)(3) excludes from its perfection and priority rules, the issuer or nominated

person must comply with the normal method of perfection (e.g., possession of an instrument) and is subject to the applicable Article 9 priority rules. Documents to which subsection (b)(3) applies may be important to an issuer or nominated person. For example, a confirmer who pays the beneficiary must be assured that its rights to all documents are not impaired. It will find it necessary to present all of the required documents to the issuer in order to be reimbursed. Moreover, when a nominated person sends documents to an issuer in connection with the nominated person's reimbursement, that activity is not a collection, enforcement, or disposition of collateral under Article 9.

One purpose of this section is to protect an issuer or nominated person from claims of a beneficiary's creditors. It is a fallback provision inasmuch as issuers and nominated persons frequently may obtain and perfect security interests under the usual Article 9 rules, and, in many cases, the documents will be owned by the issuer, nominated person, or applicant.

Chapter 6
UNIFORM COMMERCIAL CODE — BULK TRANSFERS

Sec.

§ 28-6-101 — 28-6-111. Uniform Commercial Code — Bulk Transfers. [Repealed.]

STATUTORY NOTES

Compiler's Notes.

The following sections were repealed by S.L. 1993, ch. 288, § 46, effective July 1, 1993: 28-6-101. (1967, ch. 161, § 6-101, p. 351).

28-6-102. (1967, ch. 161, § 6-102, p. 351).

28-6-103. (1967, ch. 161, § 6-103, p. 351).

28-6-104. (1967, ch. 161, § 6-104, p. 351).

28-6-105. (1967, ch. 161, § 6-105, p. 351).

28-6-106. (1967, ch. 161, § 6-106, p. 351).

28-6-107. (1967, ch. 161, § 6-107, p. 351).

28-6-108. (1967, ch. 161, § 6-108, p. 351).

28-6-109. (1967, ch. 161, § 6-109, p. 351).

28-6-110. (1967, ch. 161, § 6-110, p. 351).

28-6-111. (1967, ch. 161, § 6-111, p. 351).

Section 54 of S.L. 1993, ch. 288 read: "Rights and obligations that arose under Chapter 6, Title 28, Idaho Code, and Section 28-9-111, Idaho Code, before their repeal remain valid and may be enforced as though those statutes had not been repealed."

Chapter 7
DOCUMENTS OF TITLE

Part 1. General

Sec.

Part 2. Warehouse Receipts — Special Provisions

Part 3. Bills of Lading — Special Provisions

Part 6. Warehouse Receipts and Bills of Lading — Miscellaneous Provisions

Part 7. Miscellaneous Provisions

Part 1
General

Idaho Code § 28-7-101

§ 28-7-101. Short title. — This chapter shall be known and may be cited as "Uniform Commercial Code — Documents of Title."

History.

I.C., § 28-7-101, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-101, which comprised 1967, ch. 161, § 7-101, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

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CASE NOTES

Cited Smith v. Great Basin Grain Co., 98 Idaho 266, 561 P.2d 1299 (1977).

RESEARCH REFERENCES

Am. Jur. 2d. — 11 Am. Jur. 2d, Bills and Notes, § 1 et seq.

15A Am. Jur. 2d, Commercial Code, § 34 et seq.

ALR. — Construction and effect of UCC Art 7, dealing with warehouse receipts, bills of lading, and other documents of title. 21 A.L.R.3d 1339.

Validity, construction, and effect of provision in shipping contract or bill of lading that carrier shall have benefit of shipper's insurance against loss of

or damage to shipment. 27 A.L.R.3d 984.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-101.

Changes: Revised for style only.

This Article is a revision of the 1962 Official Text with Comments as amended since 1962. The 1962 Official Text was a consolidation and revision of the Uniform Warehouse Receipts Act and the Uniform Bills of Lading Act, and embraced the provisions of the Uniform Sales Act relating to negotiation of documents of title.

This Article does not contain the substantive criminal provisions found in the Uniform Warehouse Receipts and Bills of Lading Acts. These criminal provisions are inappropriate to a Commercial Code, and for the most part duplicate portions of the ordinary criminal law relating to frauds. This revision deletes the former Section 7-105 that provided that courts could apply a rule from Parts 2 and 3 by analogy to a situation not explicitly covered in the provisions on warehouse receipts or bills of lading when it was appropriate. This is, of course, an unexceptional proposition and need not be stated explicitly in the statute. Thus former Section 7-105 has been deleted. Whether applying a rule by analogy to a situation is appropriate depends upon the facts of each case.

The Article does not attempt to define the tort liability of bailees, except to hold certain classes of bailees to a minimum standard of reasonable care. For important classes of bailees, liabilities in case of loss, damages or destruction, as well as other legal questions associated with particular documents of title, are governed by federal statutes, international treaties, and in some cases regulatory state laws, which supersede the provisions of this Article in case of inconsistency. See Section 7-103.

§ 28-7-102. Definitions and index of definitions. — (a) In this chapter, unless the context otherwise requires:

(1) "Bailee" means a person that by a warehouse receipt, bill of lading, or other document of title acknowledges possession of goods and contracts to deliver them.

(2) "Carrier" means a person that issues a bill of lading.

(3) "Consignee" means a person named in a bill of lading to which or to whose order the bill promises delivery.

(4) "Consignor" means a person named in a bill of lading as the person from which the goods have been received for shipment.

(5) "Delivery order" means a record that contains an order to deliver goods directed to a warehouse, carrier, or other person that in the ordinary course of business issues warehouse receipts or bills of lading.

(6) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(7) "Goods" means all things that are treated as movable for the purposes of a contract for storage or transportation.

(8) "Issuer" means a bailee that issues a document of title or, in the case of an unaccepted delivery order, the person that orders the possessor of goods to deliver. The term includes a person for which an agent or employee purports to act in issuing a document if the agent or employee has real or apparent authority to issue documents, even if the issuer did not receive any goods, the goods were misdescribed, or in any other respect the agent or employee violated the issuer's instructions.

(9) "Person entitled under the document" means the holder, in the case of a negotiable document of title, or the person to which delivery of the goods is to be made by the terms of, or pursuant to instructions in a record under, a nonnegotiable document of title.

(10) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in

perceivable form.

(11) "Sign" means, with present intent to authenticate or adopt a record: (A) To execute or adopt a tangible symbol; or (B) To attach to or logically associate with the record an electronic sound, symbol, or process.

(12) "Shipper" means a person that enters into a contract of transportation with a carrier.

(13) "Warehouse" means a person engaged in the business of storing goods for hire.

(b) Definitions in other chapters applying to this chapter and the sections in which they appear are: (1) "Contract for sale," section 28-2-106[, Idaho Code].

(2) "Lessee in ordinary course," section 28-12-103[, Idaho Code].

(3) "Receipt" of goods, section 28-2-103[, Idaho Code].

(c) In addition, chapter 1, title 28, Idaho Code, contains general definitions and principles of construction and interpretation applicable throughout this chapter.

History.

I.C., § 28-7-102, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-102, which comprised 1967, ch. 161, § 7-102, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertions in paragraphs (b)(1), (b)(2), and (b)(3) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Goods.

Warehouseman.

Goods.

Agreement to pay full face value of note upon demand was not contract for sale of "goods" under uniform sales law. Wallace Bank & Trust Co. v. First Nat'l Bank, 40 Idaho 712, 237 P. 284 (1925).

Warehouseman.

Former corporate agent of corporations which handled their records and stock transfers was not a "warehouseman" entitled to a possessory lien on their records for payment of fees. Silver Bowl, Inc. v. Equity Metals, Inc., 93 Idaho 487, 464 P.2d 926 (1970).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, §§ 35, 45.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-102.

Changes: New definitions of "carrier," "good faith," "record," "sign," and "shipper." Other definitions revised to accommodate electronic mediums.

Purposes:

1. "Bailee" is used in this Article as a blanket term to designate carriers, warehousemen and others who normally issue documents of title on the basis of goods which they have received. The definition does not, however, require actual possession of the goods. If a bailee acknowledges possession when it does not have possession, the bailee is bound by sections of this Article which declare the "bailee's" obligations. (See definition of "Issuer" in this section and Sections 7-203 and 7-301 on liability in case of non-receipt.) A "carrier" is one type of bailee and is defined as a person that issues a bill of lading. A "shipper" is a person who enters into the contract of transportation with the carrier. The definitions of "bailee," "consignee," "consignor," "goods", and "issuer", are unchanged in substance from prior

law. “Document of title” is defined in Article 1, and may be in either tangible or electronic form.

2. The definition of warehouse receipt contained in the general definitions section of this Act (Section 1-201) does not require that the issuing warehouse be “lawfully engaged” in business or for profit. The warehouse’s compliance with applicable state regulations such as the filing of a bond has no bearing on the substantive issues dealt with in this Article. Certainly the issuer’s violations of law should not diminish its responsibility on documents the issuer has put in commercial circulation. But it is still essential that the business be storing goods “for hire” (Section 1-201 and this section). A person does not become a warehouse by storing its own goods.

3. When a delivery order has been accepted by the bailee it is for practical purposes indistinguishable from a warehouse receipt. Prior to such acceptance there is no basis for imposing obligations on the bailee other than the ordinary obligation of contract which the bailee may have assumed to the depositor of the goods. Delivery orders may be either electronic or tangible documents of title. See definition of “document of title” in Section 1-201.

4. The obligation of good faith imposed by this Article and by Article 1, Section 1-304 includes the observance of reasonable commercial standards of fair dealing.

5. The definitions of “record” and “sign” are included to facilitate electronic mediums. See Comment 9 to Section 9-102 discussing “record” and the comment to amended Section 2-103 discussing “sign.”

6. “Person entitled under the document” is moved from former Section 7-403.

7. These definitions apply in this Article unless the context otherwise requires. The “context” is intended to refer to the context in which the defined term is used in the Uniform Commercial Code. The definition applies whenever the defined term is used unless the context in which the defined term is used in the statute indicates that the term was not used in its defined sense. See comment to Section 1-201.

Cross References:

Point 1: Sections 1-201, 7-203 and 7-301.

Point 2: Sections 1-201 and 7-203.

Point 3: Section 1-201.

Point 4: Section 1-304.

Point 5: Sections 9-102 and 2-103.

See general comment to document of title in Section 1-201.

Definitional Cross References: "Bill of lading". Section 1-201.

"Contract". Section 1-201.

"Contract for sale". Section 2-106.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Receipt of goods". Section 2-103.

"Right". Section 1-201.

"Warehouse receipt". Section 1-201.

§ 28-7-103. Relation of chapter to treaty or statute. — (a) This chapter is subject to any treaty or statute of the United States or regulatory statute of this state to the extent the treaty, statute, or regulatory statute is applicable.

(b) This chapter does not modify or repeal any law prescribing the form or content of a document of title or the services or facilities to be afforded by a bailee, or otherwise regulating a bailee's business in respects not specifically treated in this chapter. However, violation of such a law does not affect the status of a document of title that otherwise is within the definition of a document of title.

(c) This chapter modifies, limits, and supersedes the federal electronic signatures in global and national commerce act (15 U.S.C. 7001, et seq.) but does not modify, limit, or supersede section 101(c) of that act (15 U.S.C. 7001(c)) or authorize electronic delivery of any of the notices described in section 103(b) of that act (15 U.S.C. 7003(b)).

(d) To the extent there is a conflict between the uniform electronic transactions act, chapter 50, title 28, Idaho Code, and this chapter, this chapter governs.

History.

I.C., § 28-7-103, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-103, which comprised 1967, ch. 161, § 7-103, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 34 et seq.

Official Comment

Prior Uniform Statutory Provisions: Former Sections 7-103 and 10-104.

Changes: Deletion of references to tariffs and classifications; incorporation of former Section 10-104 into subsection (b), provide for intersection with federal and state law governing electronic transactions.

Purposes:

1. To make clear what would of course be true without the Section, that applicable federal law is paramount.

2. To make clear also that regulatory state statutes (such as those fixing or authorizing a commission to fix rates and prescribe services, authorizing different charges for goods of different values, and limiting liability for loss to the declared value on which the charge was based) are not affected by the Article and are controlling on the matters which they cover unless preempted by federal law. The reference in former Section 7-103 to tariffs, classifications, and regulations filed or issued pursuant to regulatory state statutes has been deleted as inappropriate in the modern era of diminished regulation of carriers and warehouses. If a regulatory scheme requires a carrier or warehouse to issue a tariff or classification, that tariff or classification would be given effect via the state regulatory scheme that this Article recognizes as controlling. Permissive tariffs or classifications would not displace the provisions of this act, pursuant to this section, but may be given effect through the ability of parties to incorporate those terms by reference into their agreement.

3. The document of title provisions of this act supplement the federal law and regulatory state law governing bailees. This Article focuses on the commercial importance and usage of documents of title. State ex rel Public Service Commission v. Gunkelman & Sons, Inc., 219 N.W.2d 853 (N.D. 1974).

4. Subsection (c) is included to make clear the interrelationship between the federal Electronic Signatures in Global and National Commerce Act and this Article and the conforming amendments to other articles of the Uniform Commercial Code promulgated as part of the revision of this Article. Section 102 of the federal act allows a State statute to modify, limit,

or supersede the provisions of Section 101 of the federal act. See the comments to Revised Article 1, Section 1-108.

5. Subsection (d) makes clear that once this Article is in effect, its provisions regarding electronic commerce and regarding electronic documents of title control in the event there is a conflict with the provisions of the Uniform Electronic Transactions Act or other applicable state law governing electronic transactions.

Cross References:

Sections 1-108, 7-201, 7-202, 7-204, 7-206, 7-309, 7-401, 7-403.

Definitional Cross Reference:

“Bill of lading”. Section 1-201.

§ 28-7-104. Negotiable and nonnegotiable document of title. — (a) Except as otherwise provided in subsection (c) of this section, a document of title is negotiable if by its terms the goods are to be delivered to bearer or to the order of a named person.

(b) A document of title other than one described in subsection (a) of this section is nonnegotiable. A bill of lading that states that the goods are consigned to a named person is not made negotiable by a provision that the goods are to be delivered only against an order in a record signed by the same or another named person.

(c) A document of title is nonnegotiable if, at the time it is issued, the document has a conspicuous legend, however expressed, that it is nonnegotiable.

History.

I.C., § 28-7-104, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-104, which comprised 1967, ch. 161, § 7-104, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law Omission of Storage Rate.

Receipts were held not to be invalid or nonnegotiable on account of omission of rate of storage. Equitable Trust Co. v. A.C. White Lumber Co., 41 F.2d 60 (D. Idaho 1930).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 52.

68A Am. Jur. 2d, Secured Transactions, § 41.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-104.

Changes: Subsection (a) is revised to reflect modern style and trade practice. Subsection (b) is revised for style and medium neutrality. Subsection (c) is new.

Purposes: 1. This Article deals with a class of commercial paper representing commodities in storage or transportation. This "commodity paper" is to be distinguished from what might be called "money paper" dealt with in the Article of this Act on Commercial Paper (Article 3) and "investment paper" dealt with in the Article of this Act on Investment Securities (Article 8). The class of "commodity paper" is designated "document of title" following the terminology of the Uniform Sales Act Section 76. Section 1-201. The distinctions between negotiable and nonnegotiable documents in this section makes the most important subclassification employed in the Article, in that the holder of negotiable documents may acquire more rights than its transferor had (See Section 7-502). The former Section 7-104, which provided that a document of title was negotiable if it runs to a named person or assigns if such designation was recognized in overseas trade, has been deleted as not necessary in light of current commercial practice.

A document of title is negotiable only if it satisfies this section. "Deliverable on proper indorsement and surrender of this receipt" will not render a document negotiable. Bailees often include such provisions as a means of insuring return of nonnegotiable receipts for record purposes. Such language may be regarded as insistence by the bailee upon a particular kind of receipt in connection with delivery of the goods. Subsection (a) makes it clear that a document is not negotiable which provides for delivery to order or bearer only if written instructions to that effect are given by a named person. Either tangible or electronic documents of title may be negotiable if the document meets the requirement of this section.

2. Subsection (c) is derived from Section 3-104(d). Prior to issuance of the document of title, an issuer may stamp or otherwise provide by a notation on the document that it is nonnegotiable even if the document would otherwise comply with the requirement of subsection (a). Once

issued as a negotiable document of title, the document cannot be changed from a negotiable document to a nonnegotiable document. A document of title that is nonnegotiable cannot be made negotiable by stamping or providing a notation that the document is negotiable. The only way to make a document of title negotiable is to comply with subsection (a). A negotiable document of title may fail to be duly negotiated if the negotiation does not comply with the requirements for "due negotiation" stated in Section 7-501.

Cross References: Sections 7-501 and 7-502.

Definitional Cross References: "Bearer". Section 1-201.

"Bill of lading". Section 1-201.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Person". Section 1-201.

"Sign". Section 7-102.

"Warehouse receipt". Section 1-201.

§ 28-7-105. Reissuance in alternative medium. — (a) Upon request of a person entitled under an electronic document of title, the issuer of the electronic document may issue a tangible document of title as a substitute for the electronic document if:

(1) The person entitled under the electronic document surrenders control of the document to the issuer; and

(2) The tangible document when issued contains a statement that it is issued in substitution for the electronic document.

(b) Upon issuance of a tangible document of title in substitution for an electronic document of title in accordance with subsection (a) of this section:

(1) The electronic document ceases to have any effect or validity; and

(2) The person that procured issuance of the tangible document warrants to all subsequent persons entitled under the tangible document that the warrantor was a person entitled under the electronic document when the warrantor surrendered control of the electronic document to the issuer.

(c) Upon request of a person entitled under a tangible document of title, the issuer of the tangible document may issue an electronic document of title as a substitute for the tangible document if:

(1) The person entitled under the tangible document surrenders possession of the document to the issuer; and

(2) The electronic document when issued contains a statement that it is issued in substitution for the tangible document.

(d) Upon issuance of an electronic document of title in substitution for a tangible document of title in accordance with subsection (c) of this section:

(1) The tangible document ceases to have any effect or validity; and

(2) The person that procured issuance of the electronic document warrants to all subsequent persons entitled under the electronic document that the warrantor was a person entitled under the tangible document

when the warrantor surrendered possession of the tangible document to the issuer.

History.

I.C., § 28-7-105, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-105, which comprised 1965, ch. 161, § 7-105, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Official Comment

Prior Uniform Statutory Provisions: None.

Other relevant law: UNCITRAL Draft Instrument on the Carriage of Goods by Sea Transport Law.

Purposes:

1. This section allows for documents of title issued in one medium to be reissued in another medium. This section applies to both negotiable and nonnegotiable documents. This section sets forth minimum requirements for giving the reissued document effect and validity. The issuer is not required to issue a document in an alternative medium and if the issuer chooses to do so, it may impose additional requirements. Because a document of title imposes obligations on the issuer of the document, it is imperative for the issuer to be the one who issues the substitute document in order for the substitute document to be effective and valid.

2. The request must be made to the issuer by the person entitled to enforce the document of title (Section 7-102(a)(9)) and that person must surrender possession or control of the original document to the issuer. The reissued document must have a notation that it has been issued as a substitute for the original document. These minimum requirements must be met in order to give the substitute document effect and validity. If these minimum requirements are not met for issuance of a substitute document of title, the original document of title continues to be effective and valid. Section 7-402. However, if the minimum requirements imposed by this

section are met, in addition to any other requirements that the issuer may impose, the substitute document will be the document that is effective and valid.

3. To protect parties who subsequently take the substitute document of title, the person who procured issuance of the substitute document warrants that it was a person entitled under the original document at the time it surrendered possession or control of the original document to the issuer. This warranty is modeled after the warranty found in Section 4-209.

Cross References: Sections 7-106, 7-402 and 7-601.

Definitional Cross Reference: "Person entitled to enforce," Section 7-102.

§ 28-7-106. Control of electronic document of title. — (a) A person has control of an electronic document of title if a system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred.

(b) A system satisfies subsection (a) of this section, and a person is deemed to have control of an electronic document of title, if the document is created, stored, and assigned in such a manner that:

(1) A single authoritative copy of the document exists which is unique, identifiable, and, except as otherwise provided in subsections (b)(4), (5), and (6) of this section, unalterable;

(2) The authoritative copy identifies the person asserting control as:

(A) The person to which the document was issued; or

(B) If the authoritative copy indicates that the document has been transferred, the person to which the document was most recently transferred;

(3) The authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;

(4) Copies or amendments that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control;

(5) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) Any amendment of the authoritative copy is readily identifiable as authorized or unauthorized.

History.

I.C., § 28-7-106, as added by 2004, ch. 42, § 2, p. 77.

Official Comment

Prior Uniform Statutory Provision: Uniform Electronic Transactions Act Section 16.

Purposes:

1. The section defines "control" for electronic documents of title and derives its rules from the Uniform Electronic Transactions Act § 16 on transferrable records. Unlike UETA § 16, however, a document of title may be reissued in an alternative medium pursuant to Section 7-105. At any point in time in which a document of title is in electronic form, the control concept of this section is relevant. As under UETA § 16, the control concept embodied in this section provides the legal framework for developing systems for electronic documents of title.

2. Control of an electronic document of title substitutes for the concept of indorsement and possession in the tangible document of title context. See Section 7-501. A person with a tangible document of title delivers the document by voluntarily transferring possession and a person with an electronic document of title delivers the document by voluntarily transferring control. (Delivery is defined in Section 1-201).

3. Subsection (a) sets forth the general rule that the "system employed for evidencing the transfer of interests in the electronic document reliably establishes that person as the person to which the electronic document was issued or transferred." The key to having a system that satisfies this test is that identity of *the* person to which the document was issued or transferred must be reliably established. Of great importance to the functioning of the control concept is to be able to demonstrate, at any point in time, *the person* entitled under the electronic document. For example, a carrier may issue an electronic bill of lading by having the required information in a database that is encrypted and accessible by virtue of a password. If the computer system in which the required information is maintained identifies the person as *the* person to which the electronic bill of lading was issued or transferred, that person has control of the electronic document of title. That identification may be by virtue of passwords or other encryption methods. Registry systems may satisfy this test. For example, see the electronic warehouse receipt system established pursuant to 7 C.F.R. Part 735. This Article leaves to the market place the development of sufficient technologies and business practices that will meet the test.

An electronic document of title is evidenced by a record consisting of information stored in an electronic medium. Section 1-201. For example, a record in a computer database could be an electronic document of title assuming that it otherwise meets the definition of document of title. To the extent that third parties wish to deal in paper mediums, Section 7-105 provides a mechanism for exiting the electronic environment by having the issuer reissue the document of title in a tangible medium. Thus if a person entitled to enforce an electronic document of title causes the information in the record to be printed onto paper without the issuer's involvement in issuing the document of title pursuant to Section 7-105, that paper is not a document of title.

4. Subsection (a) sets forth the general test for control. Subsection (b) sets forth a safe harbor test that if satisfied, results in control under the general test in subsection (a). The test in subsection (b) is also used in Section 9-105 although Section 9-105 does not include the general test of subsection (a). Under subsection (b), at any point in time, a party should be able to identify the single authoritative copy which is unique and identifiable as the authoritative copy. This does not mean that once created that the authoritative copy need be static and never moved or copied from its original location. To the extent that backup systems exist which result in multiple copies, the key to this idea is that at any point in time, the one authoritative copy needs to be unique and identifiable.

Parties may not by contract provide that control exists. The test for control is a factual test that depends upon whether the general test in subsection (a) or the safe harbor in subsection (b) is satisfied.

5. Article 7 has historically provided for rights under documents of title and rights of transferees of documents of title as those rights relate to the goods covered by the document. Third parties may possess or have control of documents of title. While misfeasance or negligence in failure to transfer or misdelivery of the document by those third parties may create serious issues, this Article has never dealt with those issues as it relates to tangible documents of title, preferring to leave those issues to the law of contracts, agency and tort law. In the electronic document of title regime, third party registry systems are just beginning to develop. It is very difficult to write rules regulating those third parties without some definitive sense of how the third party registry systems will be structured. Systems that are evolving to

date tend to be “closed” systems in which all participants must sign on to the master agreement which provides for rights as against the registry system as well as rights among the members. In those closed systems, the document of title never leaves the system so the parties rely upon the master agreement as to rights against the registry for its failures in dealing with the document. This article contemplates that those “closed” systems will continue to evolve and that the control mechanism in this statute provides a method for the participants in the closed system to achieve the benefits of obtaining control allowed by this article.

This article also contemplates that parties will evolve open systems where parties need not be subject to a master agreement. In an open system a party that is expecting to obtain rights through an electronic document may not be a party to the master agreement. To the extent that open systems evolve by use of the control concept contained in this section, the law of contracts, agency, and torts as it applies to the registry’s misfeasance or negligence concerning the transfer of control of the electronic document will allocate the risks and liabilities of the parties as that other law now does so for third parties who hold tangible documents and fail to deliver the documents.

Cross References: Sections 7-105 and 7-501.

Definitional Cross References:

“Delivery”. Section 1-201.

“Document of title”. Section 1-201.

Part 2
Warehouse Receipts — Special Provisions

Idaho Code § 28-7-201

§ 28-7-201. Person that may issue a warehouse receipt — Storage under bond. — (a) A warehouse receipt may be issued by any warehouse.

(b) If goods, including distilled spirits and agricultural commodities, are stored under a statute requiring a bond against withdrawal or a license for the issuance of receipts in the nature of warehouse receipts, a receipt issued for the goods is deemed to be a warehouse receipt even if issued by a person that is the owner of the goods and is not a warehouse.

History.

I.C., § 28-7-201, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-201, which comprised 1967, ch. 161, § 7-201, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law Rights acquired.

Warehouseman as agent.

Rights Acquired.

The Bonded Warehouse Law and the Uniform Warehouse Receipts Law provided that a warehouseman did not acquire any right to the goods delivered except possession. Jensen v. United States Fid. & Guar. Co., 78 Idaho 145, 298 P.2d 976 (1956).

Warehouseman as Agent.

Where intervenor sold warehouseman all but 20,000 pounds of his 1954 oats crop for which warehouseman paid by check and both parties agreed

that warehouseman should sell remainder of 1954 crop and all of 1955 crop to a prospective buyer but when sale failed to materialize and warehouseman retained the oats and intervenor learned that warehouseman's check had failed to clear bank, intervenor made demand on warehouseman for oats and received two warehouse receipts covering the entire two crops and later check cleared the bank but the receipt for the 1954 crop was neither reduced nor canceled, the evidence was clear that the relationship between the intervenor and the warehouseman was not that of bailor-bailee, which normally results from conducting warehouse business in accordance with statutes, but was that of purchaser-seller or warehouseman was acting as commercial agent or factor for intervenor. United States v. Fireman's Fund Ins. Co., 191 F. Supp. 317 (D. Idaho 1961).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 47.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-201.

Changes: Update for style only.

Purposes: It is not intended by re-enactment of subsection (a) to repeal any provisions of special licensing or other statutes regulating who may become a warehouse. Limitations on the transfer of the receipts and criminal sanctions for violation of such limitations are not impaired. Section 7-103. Compare Section 7-401(4) on the liability of the issuer in such cases. Subsection (b) covers receipts issued by the owner for whiskey or other goods stored in bonded warehouses under such statutes as 26 U.S.C. Chapter 51.

Cross References: Sections 7-103 and 7-401.

Definitional Cross References: "Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

§ 28-7-202. Form of warehouse receipt — Effect of omission. — (a) A warehouse receipt need not be in any particular form.

(b) Unless a warehouse receipt provides for each of the following, the warehouse is liable for damages caused to a person injured by its omission: (1) A statement of the location of the warehouse facility where the goods are stored; (2) The date of issue of the receipt; (3) The unique identification code of the receipt; (4) A statement whether the goods received will be delivered to the bearer, to a named person, or to a named person or its order; (5) The rate of storage and handling charges, unless goods are stored under a field warehousing arrangement, in which case a statement of that fact is sufficient on a nonnegotiable receipt; (6) A description of the goods or the packages containing them; (7) The signature of the warehouse or its agent; (8) If the receipt is issued for goods that the warehouse owns, either solely, jointly, or in common with others, a statement of the fact of that ownership; and (9) A statement of the amount of advances made and of liabilities incurred for which the warehouse claims a lien or security interest, unless the precise amount of advances made or liabilities incurred, at the time of the issue of the receipt, is unknown to the warehouse or to its agent that issued the receipt, in which case a statement of the fact that advances have been made or liabilities incurred and the purpose of the advances or liabilities is sufficient.

(c) A warehouse may insert in its receipt any terms that are not contrary to the uniform commercial code and do not impair its obligation of delivery under section 28-7-403[, Idaho Code,] or its duty of care under section 28-7-204[, Idaho Code]. Any contrary provision is ineffective.

History.

I.C., § 28-7-202, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-202, which comprised 1967, ch. 161, § 7-202, p. 351, was repealed by 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertions in subsection (c) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Omission of Storage Rate.

Receipts were held not to be invalid or nonnegotiable on account of omission of rate of storage. Equitable Trust Co. v. A.C. White Lumber Co., 41 F.2d 60 (D. Idaho 1930).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 47.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-202.

Changes: Language is updated to accommodate electronic commerce and to reflect modern style.

Purposes:

1. This section does not displace any particular legislation that requires other terms in a warehouse receipt or that may require a particular form of a warehouse receipt. This section does not require that a warehouse receipt be issued. A warehouse receipt that is issued need not contain any of the terms listed in subsection (b) in order to qualify as a warehouse receipt as long as the receipt falls within the definition of "warehouse receipt" in Article 1. Thus the title has been changed to eliminate the phrase "essential terms" as provided in prior law. The only consequence of a warehouse receipt not containing any term listed in subsection (b) is that a person injured by a term's omission has a right as against the warehouse for harm caused by the omission. Cases, such as *In re Celotex Corp.*, 134 B.R. 993 (Bankr. M.D. Fla. 1991), that held that in order to have a valid warehouse receipt all of

the terms listed in this section must be contained in the receipt, are disapproved.

2. The unique identification code referred to in subsection (b)(3) can include any combination of letters, number, signs, and/or symbols that provide a unique identification. Whether an electronic or tangible warehouse receipt contains a signature will be resolved with the definition of sign in Section 7-102.

Cross References:

Sections 7-103 and 7-401.

Definitional Cross References: "Bearer". Section 1-201.

"Delivery". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Security interest". Section 1-201.

"Sign". Section 7-102.

"Term". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

§ 28-7-203. Liability for nonreceipt or misdescription. — A party to or purchaser for value in good faith of a document of title, other than a bill of lading, that relies upon the description of the goods in the document may recover from the issuer damages caused by the nonreceipt or misdescription of the goods, except to the extent that:

(1) The document conspicuously indicates that the issuer does not know whether all or part of the goods in fact were received or conform to the description, such as a case in which the description is in terms of marks or labels or kind, quantity, or condition, or the receipt or description is qualified by "contents, condition, and quality unknown," "said to contain," or words of similar import, if the indication is true; or (2) The party or purchaser otherwise has notice of the nonreceipt or misdescription.

History.

I.C., § 28-7-203, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-203, which comprised 1967, ch. 161, § 7-203, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law Warehouse Receipt.

In any action by one who had loaned money on the security of warehouse receipts against the warehouseman for deficiency in the quantity of logs and lumber on hand from the quantity called for in the warehouse receipts, the warehouseman was liable for the value of the missing logs and lumber as evidenced by the warehouse receipts and not merely for the pro rata amount loaned on such logs and lumber. Tri-State Nat'l Bank v. Western Gateway Storage Co., 92 Idaho 543, 447 P.2d 409 (1968).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 51.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-203.

Changes: Changes to this section are for style only.

Purpose: This section is a simplified restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor. The issuer is liable on documents issued by an agent, contrary to instructions of its principal, without receiving goods. No disclaimer of the latter liability is permitted.

Cross Reference: Section 7-301.

Definitional Cross References: "Conspicuous". Section 1-201.

"Document of title". Section 1-201.

"Goods". Section 7-102.

"Good Faith". Section 1-201 [7-102].

"Issuer". Section 7-102.

"Notice". Section 1-202.

"Party". Section 1-201.

"Purchaser". Section 1-201.

"Receipt of goods". Section 2-103.

"Value". Section 1-204.

§ 28-7-204. Duty of care — Contractual limitation of warehouse's liability. — (a) A warehouse is liable for damages for loss of or injury to the goods caused by its failure to exercise care with regard to the goods that a reasonably careful person would exercise under similar circumstances. Unless otherwise agreed, the warehouse is not liable for damages that could not have been avoided by the exercise of that care.

(b) Damages may be limited by a term in the warehouse receipt or storage agreement limiting the amount of liability in case of loss or damage beyond which the warehouse is not liable. Such a limitation is not effective with respect to the warehouse's liability for conversion to its own use. On request of the bailor in a record at the time of signing the storage agreement or within a reasonable time after receipt of the warehouse receipt, the warehouse's liability may be increased on part or all of the goods covered by the storage agreement or the warehouse receipt. In this event, increased rates may be charged based on an increased valuation of the goods.

(c) Reasonable provisions as to the time and manner of presenting claims and commencing actions based on the bailment may be included in the warehouse receipt or storage agreement.

History.

I.C., § 28-7-204, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-204, which comprised 1967, ch. 161, § 7-204, p. 351; am. 1982, ch. 24, § 2, p. 31, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law

Loss Caused by Fire.

Statutory provision was a restatement of common law that, in the absence of contract or statute, the liability of a warehouseman for loss of stored goods by fire was limited to his failure to exercise due care. Shockley v. Tennyson Transf. & Storage, Inc., 76 Idaho 131, 278 P.2d 795 (1955).

Determination by trial court that warehouseman had failed to show that fire was not due to his negligence, or lack of due care was in substance a finding of lack of required care. Shockley v. Tennyson Transf. & Storage, Inc., 76 Idaho 131, 278 P.2d 795 (1955).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 47.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-204.

Changes: Updated to reflect modern, standard commercial practices.

Purposes:

1. Subsection (a) continues the rule without change from former Section 7-204 on the warehouse's obligation to exercise reasonable care.

2. Former Section 7-204(2) required that the term limiting damages do so by setting forth a specific liability per article or item or of a value per unit of weight. This requirement has been deleted as out of step with modern industry practice. Under subsection (b) a warehouse may limit its liability for damages for loss of or damage to the goods by a term in the warehouse receipt or storage agreement without the term constituting an impermissible disclaimer of the obligation of reasonable care. The parties cannot disclaim by contract the warehouse's obligation of care. Section 1-302. For example, limitations based upon per unit of weight, per package, per occurrence, or per receipt as well as limitations based upon a multiple of the storage rate may be commercially appropriate. As subsection (d) makes clear, the states or the federal government may supplement this section with more rigid standards of responsibility for some or all bailees.

3. Former Section 7-204(2) also provided that an increased rate can not be charged if contrary to a tariff. That language has been deleted. If a tariff

is required under state or federal law, pursuant to Section 7-103(a), the tariff would control over the rule of this section allowing an increased rate. The provisions of a non-mandatory tariff may be incorporated by reference in the parties' agreement. See Comment 2 to Section 7-103. Subsection (c) deletes the reference to tariffs for the same reason that the reference has been omitted in subsection (b).

4. As under former Section 7-204(2), subsection (b) provides that a limitation of damages is ineffective if the warehouse has converted the goods to its own use. A mere failure to redeliver the goods is not conversion to the warehouse's own use. See *Adams v. Ryan & Christie Storage, Inc.*, 563 F. Supp. 409 (E.D. Pa. 1983) aff'd 725 F.2d 666 (3rd Cir. 1983). Cases such as *I.C.C. Metals Inc. v. Municipal Warehouse Co*, 409 N.E. 2d 849 (N.Y. Ct. App. 1980) holding that mere failure to redeliver results in a presumption of conversion to the warehouse's own use are disapproved. "Conversion to its own use" is narrower than the idea of conversion generally. Cases such as *Lipman v. Peterson*, 575 P.2d 19 (Kan. 1978) holding to the contrary are disapproved.

5. Storage agreements commonly establish the contractual relationship between warehouses and depositors who have an on-going relationship. The storage agreement may allow for the movement of goods into and out of a warehouse without the necessity of issuing or amending a warehouse receipt upon each entry or exit of goods from the warehouse.

Cross References: Sections 1-302, 7-103, 7-309 and 7-403.

Definitional Cross References: "Goods". Section 7-102.

"Reasonable time". Section 1-204 [1-205].

"Sign". Section 7-102.

"Term". Section 1-201.

"Value". Section 1-204.

"Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

§ 28-7-205. Title under warehouse receipt defeated in certain cases. — A buyer in ordinary course of business of fungible goods sold and delivered by a warehouse that is also in the business of buying and selling such goods takes the goods free of any claim under a warehouse receipt even if the receipt is negotiable and has been duly negotiated.

History.

I.C., § 28-7-205, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-205, which comprised 1967, ch. 161, § 7-205, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law

Delivery.

Delivery can, in some circumstances, be effectuated without a change of possession, but actual delivery must be required where fungible goods are left in the possession of a warehouseman by the purchaser in order for the entrustment provisions to be effective. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Delivery to the purchaser is required by this section before a purchaser takes free of any claim under a warehouse receipt. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Entrustment.

To require delivery to the purchaser of the goods under the entrustment provisions, particularly in the instance of fungible goods in warehouses,

illustrates the basic purpose of the entrustment theory which is to afford protection to a bona fide purchaser in the ordinary course of business. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 60 et seq.

67 Am. Jur. 2d, Sales, § 434 et seq.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-205.

Changes: Changes for style only.

Purposes:

1. The typical case covered by this section is that of the warehouse-dealer in grain, and the substantive question at issue is whether in case the warehouse becomes insolvent the receipt holders shall be able to trace and recover grain shipped to farmers and other purchasers from the elevator. This was possible under the old acts, although courts were eager to find estoppels to prevent it. The practical difficulty of tracing fungible grain means that the preservation of this theoretical right adds little to the commercial acceptability of negotiable grain receipts, which really circulate on the credit of the warehouse. Moreover, on default of the warehouse, the receipt holders at least share in what grain remains, whereas retaking the grain from a good faith cash purchaser reduces the purchaser completely to the status of general creditor in a situation where there was very little the purchaser could do to guard against the loss. Compare 15 U.S.C. Section 714p enacted in 1955.

2. This provision applies to both negotiable and nonnegotiable warehouse receipts. The concept of due negotiation is provided for in Section 7-501. The definition of "buyer in ordinary course" is in Article 1 and provides, among other things, that a buyer must either have possession or a right to obtain the goods under Article 2 in order to be a buyer in ordinary course. This section requires actual delivery of the fungible goods to the buyer in ordinary course. Delivery requires voluntary transfer of possession of the

fungible goods to the buyer. See amended Section 2-103. This section is not satisfied by the delivery of the document of title to the buyer in ordinary course.

Cross References: Sections 2-403 and 9-320.

Definitional Cross References: "Buyer in ordinary course of business". Section 1-201.

"Delivery". Section 1-201.

"Duly negotiate". Section 7-501.

"Fungible" goods. Section 1-201.

"Goods". Section 7-102.

"Value". Section 1-204.

"Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

§ 28-7-206. Termination of storage at warehouse's option. — (a) A warehouse, by giving notice to the person on whose account the goods are held and any other person known to claim an interest in the goods, may require payment of any charges and removal of the goods from the warehouse at the termination of the period of storage fixed by the document of title or, if a period is not fixed, within a stated period not less than thirty (30) days after the warehouse gives notice. If the goods are not removed before the date specified in the notice, the warehouse may sell them pursuant to section 28-7-210[, Idaho Code].

(b) If a warehouse in good faith believes that goods are about to deteriorate or decline in value to less than the amount of its lien within the time provided in subsection (a) of this section and section 28-7-210[, Idaho Code], the warehouse may specify in the notice given under subsection (a) of this section any reasonable shorter time for removal of the goods and, if the goods are not removed, may sell them at public sale held not less than one (1) week after a single advertisement or posting.

(c) If, as a result of a quality or condition of the goods of which the warehouse did not have notice at the time of deposit, the goods are a hazard to other property, the warehouse facilities, or other persons, the warehouse may sell the goods at public or private sale without advertisement or posting on reasonable notification to all persons known to claim an interest in the goods. If the warehouse, after a reasonable effort, is unable to sell the goods, it may dispose of them in any lawful manner and does not incur liability by reason of that disposition.

(d) A warehouse shall deliver the goods to any person entitled to them under this chapter upon due demand made at any time before sale or other disposition under this section.

(e) A warehouse may satisfy its lien from the proceeds of any sale or disposition under this section but shall hold the balance for delivery on the demand of any person to which the warehouse would have been bound to deliver the goods.

History.

I.C., § 28-7-206, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-206, which comprised 1967, ch. 161, § 7-206, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertions in subsections (a) and (b) were added by the compiler to conform to the statutory citation style.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-206.

Changes: Changes for style.

Purposes: 1. This section provides for three situations in which the warehouse may terminate storage for reasons other than enforcement of its lien as permitted by Section 7-210. Most warehousing is for an indefinite term, the bailor being entitled to delivery on reasonable demand. It is necessary to define the warehouse's power to terminate the bailment, since it would be commercially intolerable to allow warehouses to order removal of the goods on short notice. The thirty day period provided where the document does not carry its own period of termination corresponds to commercial practice of computing rates on a monthly basis. The right to terminate under subsection (a) includes a right to require payment of "any charges", but does not depend on the existence of unpaid charges.

2. In permitting expeditious disposition of perishable and hazardous goods the pre-Code Uniform Warehouse Receipts Act, Section 34, made no distinction between cases where the warehouse knowingly undertook to store such goods and cases where the goods were discovered to be of that character subsequent to storage. The former situation presents no such emergency as justifies the summary power of removal and sale. Subsections (b) and (c) distinguish between the two situations. The reason of this section should apply if the goods become hazardous during the course of storage. The process for selling the goods described in Section 7-210 governs the

sale of goods under this section except as provided in subsections (b) and (c) for the situations described in those subsections respectively.

3. Protection of its lien is the only interest which the warehouse has to justify summary sale of perishable goods which are not hazardous. This same interest must be recognized when the stored goods, although not perishable, decline in market value to a point which threatens the warehouse's security.

4. The right to order removal of stored goods is subject to provisions of the public warehousing laws of some states forbidding warehouses from discriminating among customers. Nor does the section relieve the warehouse of any obligation under the state laws to secure the approval of a public official before disposing of deteriorating goods. Such regulatory statutes and the regulations under them remain in force and operative. Section 7-103.

Cross References: Sections 7-103 and 7-403.

Definitional Cross References: "Delivery". Section 1-201.

"Document of title". Section 1-102.

"Good faith". Section 1-201 [7-102].

"Goods". Section 7-102.

"Notice". Section 1-202.

"Notification". Section 1-202.

"Person". Section 1-201.

"Reasonable time". Section 1-205.

"Value". Section 1-204.

"Warehouse". Section 7-102.

§ 28-7-207. Goods must be kept separate — Fungible goods. — (a) Unless the warehouse receipt provides otherwise, a warehouse shall keep separate the goods covered by each receipt so as to permit at all times identification and delivery of those goods. However, different lots of fungible goods may be commingled.

(b) If different lots of fungible goods are commingled, the goods are owned in common by the persons entitled thereto and the warehouse is severally liable to each owner for that owner's share. If, because of overissue, a mass of fungible goods is insufficient to meet all the receipts the warehouse has issued against it, the persons entitled include all holders to which overissued receipts have been duly negotiated.

History.

I.C., § 28-7-207, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-207, which comprised 1967, ch. 161, § 7-207, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law Commodity purchaser.

Delivery.

Loss liability.

Commodity Purchaser.

The purpose and intent of subsections (2) and (3) of § 28-2-403 are to afford title protection to a commodity purchaser as against the unpaid depositor of the commodity in situations other than a warehouse in a shortage position. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Delivery.

Delivery can, in some circumstances, be effectuated without a change of possession, but actual delivery must be required where fungible goods are left in the possession of a warehouseman by the purchaser in order for the entrustment provisions to be effective. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Loss Liability.

Where the possession of beans was entrusted under storage conditions, the purchasers had to share in the loss on the pro-rata provisions of subsection (2) of this section and there was nothing contained in § 28-2-403 which dictated a contrary result. In re Hawkins Co., 104 Bankr. 317 (Bankr. D. Idaho 1989).

Official Comment

Prior Uniform Statutory Provision: Former Section 7-207.

Changes: Changes for style only.

Purpose: No change of substance is made from former Section 7-207. Holders to whom overissued receipts have been duly negotiated shall share in a mass of fungible goods. Where individual ownership interests are merged into claims on a common fund, as is necessarily the case with fungible goods, there is no policy reason for discriminating between successive purchasers of similar claims.

Definitional Cross References: "Delivery". Section 1-201.

"Duly negotiate". Section 7-501.

"Fungible" goods. Section 1-201.

"Goods". Section 7-102.

"Holder". Section 1-201.

"Person". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

§ 28-7-208. Altered warehouse receipts. — If a blank in a negotiable tangible warehouse receipt has been filled in without authority, a good-faith purchaser for value and without notice of the lack of authority may treat the insertion as authorized. Any other unauthorized alteration leaves any tangible or electronic warehouse receipt enforceable against the issuer according to its original tenor.

History.

I.C., § 28-7-208, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-208, which comprised 1967, ch. 161, § 7-208, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 42 et seq.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-208.

Changes: To accommodate electronic documents of title.

Purposes: 1. The execution of tangible warehouse receipts in blank is a dangerous practice. As between the issuer and an innocent purchaser the risks should clearly fall on the former. The purchaser must have purchased the tangible negotiable warehouse receipt in good faith and for value to be protected under the rule of the first sentence which is a limited exception to the general rule in the second sentence. Electronic document of title systems should have protection against unauthorized access and unauthorized changes. See Section 7-106. Thus the protection for good faith purchasers found in the first sentence is not necessary in the context of electronic documents.

2. Under the second sentence of this section, an unauthorized alteration whether made with or without fraudulent intent does not relieve the issuer of its liability on the warehouse receipt as originally executed. The unauthorized alteration itself is of course ineffective against the warehouse. The rule stated in the second sentence applies to both tangible and electronic warehouse receipts.

Definitional Cross References: "Good faith". Section 1-201 [7-102].

"Issuer". Section 7-102.

"Notice". Section 1-202.

"Purchaser". Section 1-201.

"Value". Section 1-204.

"Warehouse receipt". Section 1-201.

§ 28-7-209. Lien of warehouse. — (a) A warehouse has a lien against the bailor on the goods covered by a warehouse receipt or storage agreement or on the proceeds thereof in its possession for charges for storage or transportation, including demurrage and terminal charges, insurance, labor, or other charges, present or future, in relation to the goods, and for expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law. If the person on whose account the goods are held is liable for similar charges or expenses in relation to other goods whenever deposited and it is stated in the warehouse receipt or storage agreement that a lien is claimed for charges and expenses in relation to other goods, the warehouse also has a lien against the goods covered by the warehouse receipt or storage agreement or on the proceeds thereof in its possession for those charges and expenses, whether or not the other goods have been delivered by the warehouse. However, as against a person to which a negotiable warehouse receipt is duly negotiated, a warehouse's lien is limited to charges in an amount or at a rate specified in the warehouse receipt or, if no charges are so specified, to a reasonable charge for storage of the specific goods covered by the receipt subsequent to the date of the receipt.

(b) A warehouse may also reserve a security interest against the bailor for the maximum amount specified on the receipt for charges other than those specified in subsection (a) of this section, such as for money advanced and interest. The security interest is governed by chapter 9, title 28, Idaho Code.

(c) A warehouse's lien for charges and expenses under subsection (a) of this section or a security interest under subsection (b) of this section is also effective against any person that so entrusted the bailor with possession of the goods that a pledge of them by the bailor to a good-faith purchaser for value would have been valid. However, the lien or security interest is not effective against a person that before issuance of a document of title had a legal interest or a perfected security interest in the goods and that did not:

(1) Deliver or entrust the goods or any document of title covering the goods to the bailor or the bailor's nominee with:

(A) Actual or apparent authority to ship, store, or sell;

(B) Power to obtain delivery under section 28-7-403[, Idaho Code]; or

(C) Power of disposition under section 28-2-403, 28-12-304(2), 28-12-305(2), 28-9-320 or 28-9-321(c)[, Idaho Code], or other statute or rule of law; or

(2) Acquiesce in the procurement by the bailor or its nominee of any document.

(d) A warehouse's lien on household goods for charges and expenses in relation to the goods under subsection (a) of this section is also effective against all persons if the depositor was the legal possessor of the goods at the time of deposit. In this subsection, "household goods" means furniture, furnishings, or personal effects used by the depositor in a dwelling.

(e) A warehouse loses its lien on any goods that it voluntarily delivers or unjustifiably refuses to deliver.

History.

I.C., § 28-7-209, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-209, which comprised 1967, ch. 161, § 7-209, p. 351; am. S.L. 1973, ch. 174, § p. 383, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertions in paragraphs (c)(1)(B) and (c)(1)(C) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Chattel mortgages.

Possession by sheriff.

Warehouseman.

Warehouseman's liens.

Chattel Mortgages.

Warehouseman's lien was not superior to lien of chattel mortgage on stored goods, unless mortgagee consents to storage, in which event it took precedence. Vollmer Clearwater Co. v. Union Whse. & Supply Co., 43 Idaho 37, 248 P. 865 (1926).

Possession by Sheriff.

For purposes of a warehouseman's lien under this section, it is necessary to determine only whether a sheriff's possession was legal at the time seized property was deposited with the warehouseman. Peasley Transfer & Storage Co. v. Smith, 132 Idaho 732, 979 P.2d 605 (1999).

Where a sheriff had properly seized property pursuant to a facially valid writ, he was a "legal possessor" for purposes of this section. Peasley Transfer & Storage Co. v. Smith, 132 Idaho 732, 979 P.2d 605 (1999).

Warehouseman.

Former corporate agent of corporations, which handled their records and stock transfers, was not a "warehouseman" entitled to a possessory lien on their records for payment of fees. Silver Bowl, Inc. v. Equity Metals, Inc., 93 Idaho 487, 464 P.2d 926 (1970).

Warehouseman's Liens.

Section 45-805, so far as it relates to warehouse liens, was repealed by the enactment of this section. Although § 45-805 is not listed in § 28-10-102(1) as one of the statutes specifically repealed by the UCC, § 45-805 is inconsistent with this section. The exception to repeal by implication contained in § 28-10-104(1) [now repealed] does not apply to the repeal of § 45-805, so far as it relates to warehouse liens. Curry Grain Storage, Inc. v. Hesston Corp., 120 Idaho 328, 815 P.2d 1068 (1991).

Warehouseman's lien on seed was not effective against equipment manufacturer's security interest in seed since its security interest in the seed was perfected before the seed was delivered to the warehouseman; therefore, the manufacturer's security interest had priority. Curry Grain Storage, Inc. v. Hesston Corp., 120 Idaho 328, 815 P.2d 1068 (1991).

RESEARCH REFERENCES

Am. Jur. 2d. — 68A Am. Jur. 2d, Secured Transactions, § 834 et seq.

Official Comment

Prior Uniform Statutory Provision: Former Sections 7-209 and 7-503.

Changes: Expanded to recognize warehouse lien when a warehouse receipt is not issued but goods are covered by a storage agreement.

Purposes:

1. Subsection (a) defines the warehouse's statutory lien. Other than allowing a warehouse to claim a lien under this section when there is a storage agreement and not a warehouse receipt, this section remains unchanged in substance from former Section 7-209(1). Under the first sentence, a specific lien attaches automatically without express notation on the receipt or storage agreement with regard to goods stored under the receipt or the storage agreement. That lien is limited to the usual charges arising out of a storage transaction.

Example 1: Bailor stored goods with a warehouse and the warehouse issued a warehouse receipt. A lien against those goods arose as set forth in subsection (a), the first sentence, for the charges for storage and the other expenses of those goods. The warehouse may enforce its lien under Section 7-210 as against the bailor. Whether the warehouse receipt is negotiable or nonnegotiable is not important to the warehouse's rights as against the bailor.

Under the second sentence, by notation on the receipt or storage agreement, the lien can be made a general lien extending to like charges in relation to other goods. Both the specific lien and general lien are as to goods in the possession of the warehouse and extend to proceeds from the goods as long as the proceeds are in the possession of the warehouse. The same rules apply whether the receipt is negotiable or nonnegotiable.

Example 2: Bailor stored goods (lot A) with a warehouse and the warehouse issued a warehouse receipt for those goods. In the warehouse receipt it is stated that the warehouse will also have a lien on goods covered by the warehouse receipt for storage charges and the other expenses for any

other goods that are stored with the warehouse by the bailor. The statement about the lien on other goods does not specify an amount or a rate. Bailor then stored other goods (lot B) with the warehouse. Under subsection (a), first sentence, the warehouse has a lien on the specific goods (lot A) covered by the warehouse receipt. Under subsection (a), second sentence, the warehouse has a lien on the goods in lot A for the storage charges and the other expenses arising from the goods in lot B. That lien is enforceable as against the bailor regardless of whether the receipt is negotiable or nonnegotiable.

Under the third sentence, if the warehouse receipt is negotiable, the lien as against a holder of that receipt by due negotiation is limited to the amount or rate specified on the receipt for the specific lien or the general lien, or, if none is specified, to a reasonable charge for storage of the specific goods covered by the receipt for storage after the date of the receipt.

Example 3: Same facts as Example 1 except that the warehouse receipt is negotiable and has been duly negotiated (Section 7-501) to a person other than the bailor. Under the last sentence of subsection (a), the warehouse may enforce its lien against the bailor's goods stored in the warehouse as against the person to whom the negotiable warehouse receipt has been duly negotiated. Section 7-502. That lien is limited to the charges or rates specified in the receipt or a reasonable charge for storage as stated in the last sentence of subsection (a).

Example 4: Same facts as Example 2 except that the warehouse receipt is negotiable and has been duly negotiated (Section 7-501) to a person other than the bailor. Under the last sentence of subsection (a), the lien on lot A goods for the storage charges and the other expenses arising from storage of lot B goods is not enforceable as against the person to whom the receipt has been duly negotiated. Without a statement of a specified amount or rate for the general lien, the warehouse's general lien is not enforceable as against the person to whom the negotiable document has been duly negotiated. However, the warehouse lien for charges and expenses related to storage of lot A goods is still enforceable as against the person to whom the receipt was duly negotiated.

Example 5: Same facts as Examples 2 and 4 except the warehouse had stated on the negotiable warehouse receipt a specified amount or rate for the general lien on other goods (lot B). Under the last sentence of subsection (a), the general lien on lot A goods for the storage charges and the other expenses arising from storage of lot B goods is enforceable as against the person to whom the receipt has been duly negotiated.

2. Subsection (b) provides for a security interest based upon agreement. Such a security interest arises out of relations between the parties other than bailment for storage or transportation, as where the bailee assumes the role of financier or performs a manufacturing operation, extending credit in reliance upon the goods covered by the receipt. Such a security interest is not a statutory lien. Compare Sections 9-109 and 9-333. It is governed in all respects by Article 9, except that subsection (b) requires that the receipt specify a maximum amount and limits the security interest to the amount specified. A warehouse could also take a security interest to secure its charges for storage and the other expenses listed in subsection (a) to protect these claims upon the loss of the statutory possessory warehouse lien if the warehouse loses possession of the goods as provided in subsection (e).

Example 6: Bailor stores goods with a warehouse and the warehouse issues a warehouse receipt that states that the warehouse is taking a security interest in the bailed goods for charges of storage, expenses, for money advanced, for manufacturing services rendered, and all other obligations that the bailor may owe the warehouse. That is a security interest covered in all respects by Article 9. Subsection (b). As allowed by this section, a warehouse may rely upon its statutory possessory lien to protect its charges for storage and the other expenses related to storage. For those storage charges covered by the statutory possessory lien, the warehouse is not required to use a security interest under subsection (b).

3. Subsections (a) and (b) validate the lien and security interest "against the bailor." Under basic principles of derivative rights as provided in Section 7-504, the warehouse lien is also valid as against parties who obtain their rights from the bailor except as otherwise provided in subsection (a), third sentence, or subsection (c).

Example 7: Bailor stores goods with a warehouse and the warehouse issues a nonnegotiable warehouse receipt that also claims a general lien in

other goods stored with the warehouse. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor notifies the warehouse that the goods have been sold to Buyer and the bailee acknowledges that fact to the Buyer. Section 2-503. The warehouse lien for storage of those goods is effective against Buyer for both the specific lien and the general lien. Section 7-504.

Example 8: Bailor stores goods with a warehouse and the warehouse issues a nonnegotiable warehouse receipt. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor grants a security interest in the goods while the goods are in the warehouse's possession to Secured Party (SP) who properly perfects a security interest in the goods. See Revised 9-312(d). The warehouse lien is superior in priority over SP's security interest. See Revised 9-203(b)(2) (debtor can grant a security interest to the extent of debtor's rights in the collateral).

Example 9: Bailor stores goods with a warehouse and the warehouse issues a negotiable warehouse receipt. A lien on the bailed goods for the charges for storage and the other expenses arises under subsection (a). Bailor grants a security interest in the negotiable document to SP. SP properly perfects its interest in the negotiable document by taking possession through a "due negotiation." Revised 9-312(c). SP's security interest is subordinate to the warehouse lien. Section 7-209(a), third sentence. Given that bailor's rights are subject to the warehouse lien, the bailor cannot grant to the SP greater rights than the bailor has under Section 9-203(b)(2), perfection of the security interest in the negotiable document and the goods covered by the document through SP's filing of a financing statement should not give a different result.

As against third parties who have interests in the goods prior to the storage with the warehouse, subsection (c) continues the rule under the prior uniform statutory provision that to validate the lien or security interest of the warehouse, the owner must have entrusted the goods to the depositor, and that the circumstances must be such that a pledge by the depositor to a good faith purchaser for value would have been valid. Thus the owner's interest will not be subjected to a lien or security interest arising out of a deposit of its goods by a thief. The warehouse may be protected because of the actual, implied or apparent authority of the depositor, because of a

Factor's Act, or because of other circumstances which would protect a bona fide pledgee, unless those circumstances are denied effect under the second sentence of subsection (c). The language of Section 7-503 is brought into subsection (c) for purposes of clarity. The comments to Section 7-503 are helpful in interpreting delivery, entrustment or acquiescence.

Where the third party is the holder of a security interest, obtained prior to the issuance of a negotiable warehouse receipt, the rights of the warehouse depend on the priority given to a hypothetical bona fide pledgee by Article 9, particularly Section 9-322. Thus the special priority granted to statutory liens by Section 9-333 does not apply to liens under subsection (a) of this section, since subsection (c), second sentence, "expressly provides otherwise" within the meaning of Section 9-333.

As to household goods, however, subsection (d) makes the warehouse's lien "for charges and expenses in relation to the goods" effective against all persons if the depositor was the legal possessor. The purpose of the exception is to permit the warehouse to accept household goods for storage in sole reliance on the value of the goods themselves, especially in situations of family emergency.

Example 10: Bailor grants a perfected security interest in the goods to SP prior to storage of the goods with the warehouse. Bailor then stores goods with the warehouse and the warehouse issues a warehouse receipt for the goods. A warehouse lien on the bailed goods for the charges for storage or other expenses arises under subsection (a). The warehouse lien is not effective as against SP unless SP entrusted the goods to the bailor with actual or apparent authority to ship, store, or sell the goods or with power of disposition under subsection (c)(1) or acquiesced in the bailor's procurement of a document of title under subsection (c)(2). This result obtains whether the receipt is negotiable or nonnegotiable.

Example 11: Sheriff who had lawfully repossessed household goods in an eviction action stored the goods with a warehouse. A lien on the bailed goods arises under subsection (a). The lien is effective as against the owner of the goods. Subsection (d).

4. As under previous law, this section creates a statutory possessory lien in favor of the warehouse on the goods stored with the warehouse or on the

proceeds of the goods. The warehouse loses its lien if it loses possession of the goods or the proceeds. Subsection (e).

5. Where goods have been stored under a nonnegotiable warehouse receipt and are sold by the person to whom the receipt has been issued, frequently the goods are not withdrawn by the new owner. The obligations of the seller of the goods in this situation are set forth in Section 2-503(4) on tender of delivery and include procurement of an acknowledgment by the bailee of the buyer's right to possession of the goods. If a new receipt is requested, such an acknowledgment can be withheld until storage charges have been paid or provided for. The statutory lien for charges on the goods sold, granted by the first sentence of subsection (a), continues valid unless the bailee gives it up. See Section 7-403. But once a new receipt is issued to the buyer, the buyer becomes "the person on whose account the goods are held" under the second sentence of subsection (a); unless the buyer undertakes liability for charges in relation to other goods stored by the seller, there is no general lien against the buyer for such charges. Of course, the bailee may preserve the general lien in such a case either by an arrangement by which the buyer "is liable for" such charges, or by reserving a security interest under subsection (b).

6. A possessory warehouse lien arises as provided under subsection (a) if the parties to the bailment have a storage agreement or a warehouse receipt is issued. In the modern warehouse, the bailor and the bailee may enter into a master contract governing the bailment with the bailee and bailor keeping track of the goods stored pursuant to the master contract by notation on their respective books and records and the parties send notification via electronic communication as to what goods are covered by the master contract. Warehouse receipts are not issued. See Comment 4 to Section 7-204. There is no particular form for a warehouse receipt and failure to contain any of the terms listed in Section 7-202 does not deprive the warehouse of its lien that arises under subsection (a). See the comment to Section 7-202.

Cross References:

Point 1: Sections 7-501 and 7-502.

Point 2: Sections 9-109 and 9-333.

Point 3: Sections 2-503, 7-503, 7-504, 9-203, 9-312 and 9-322.

Point 4: Sections 2-503, 7-501, 7-502, 7-504, 9-312, 9-331, 9-333, and 9-401.

Point 5: Sections 2-503 and 7-403.

Point 6: Sections 7-202 and 7-204.

Definitional Cross References:

"Delivery". Section 1-201.

"Document of Title". Section 1-201.

"Goods". Section 7-102.

"Money". Section 1-201.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Right". Section 1-201.

"Security interest". Section 1-201.

"Value". Section 1-204.

"Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

§ 28-7-209A. Liens of agricultural commodity warehousemen. [Repealed.]

STATUTORY NOTES

Compiler's Notes.

This section, which comprised 1992, ch. 97, § 2, p. 311; am. 2001, ch. 208, § 12, p. 704, was repealed by S.L. 2004, ch. 42, § 1.

§ 28-7-210. Enforcement of warehouse's lien. — (a) Except as otherwise provided in subsection (b) of this section, a warehouse's lien may be enforced by public or private sale of the goods, in bulk or in packages, at any time or place and on any terms that are commercially reasonable, after notifying all persons known to claim an interest in the goods. The notification must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a method different from that selected by the warehouse is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. The warehouse sells in a commercially reasonable manner if the warehouse sells the goods in the usual manner in any recognized market therefor, sells at the price current in that market at the time of the sale, or otherwise sells in conformity with commercially reasonable practices among dealers in the type of goods sold. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable, except in cases covered by the preceding sentence.

(b) A warehouse may enforce its lien on goods, other than goods stored by a merchant in the course of its business, only if the following requirements are satisfied: (1) All persons known to claim an interest in the goods must be notified.

(2) The notification must include an itemized statement of the claim, a description of the goods subject to the lien, a demand for payment within a specified time not less than ten (10) days after receipt of the notification, and a conspicuous statement that unless the claim is paid within that time the goods will be advertised for sale and sold by auction at a specified time and place.

(3) The sale must conform to the terms of the notification.

(4) The sale must be held at the nearest suitable place to where the goods are held or stored.

(5) After the expiration of the time given in the notification, an advertisement of the sale must be published once a week for two (2) weeks consecutively in a newspaper of general circulation where the sale is to be held. The advertisement must include a description of the goods, the name of the person on whose account the goods are being held, and the time and place of the sale. The sale must take place at least fifteen (15) days after the first publication. If there is no newspaper of general circulation where the sale is to be held, the advertisement must be posted at least ten (10) days before the sale in not fewer than six (6) conspicuous places in the neighborhood of the proposed sale.

(c) Before any sale pursuant to this section, any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred in complying with this section. In that event, the goods may not be sold but must be retained by the warehouse subject to the terms of the receipt and this chapter.

(d) A warehouse may buy at any public sale held pursuant to this section.

(e) A purchaser in good faith of goods sold to enforce a warehouse's lien takes the goods free of any rights of persons against which the lien was valid, despite the warehouse's noncompliance with this section.

(f) A warehouse may satisfy its lien from the proceeds of any sale pursuant to this section but shall hold the balance, if any, for delivery on demand to any person to which the warehouse would have been bound to deliver the goods.

(g) The rights provided by this section are in addition to all other rights allowed by law to a creditor against a debtor.

(h) If a lien is on goods stored by a merchant in the course of its business, the lien may be enforced in accordance with subsection (a) or (b) of this section.

(i) A warehouse is liable for damages caused by failure to comply with the requirements for sale under this section and, in case of willful violation, is liable for conversion.

History.

I.C., § 28-7-210, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-210, which comprised 1967, ch. 161, § 7-210, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-210.

Changes: Update to accommodate electronic commerce and for style.

Purposes:

1. Subsection (a) makes "commercial reasonableness" the standard for foreclosure proceedings in all cases except non-commercial storage with a warehouse. The latter category embraces principally storage of household goods by private owners; and for such cases the detailed provisions as to notification, publication and public sale are retained in subsection (b) with one change. The requirement in former Section 7-210(2)(b) that the notification must be sent in person or by registered or certified mail has been deleted. Notification may be sent by any reasonable means as provided in Section 1-202. The swifter, more flexible procedure of subsection (a) is appropriate to commercial storage. Compare seller's power of resale on breach by buyer under the provisions of the Article on Sales (Section 2-706). Commercial reasonableness is a flexible concept that allows for a wide variety of actions to satisfy the rule of this section, including electronic means of posting and sale.

2. The provisions of subsections (d) and (e) permitting the bailee to bid at public sales and confirming the title of purchasers at foreclosure sales are designed to secure more bidding and better prices and remain unchanged from former Section 7-210.

3. A warehouse may have recourse to an interpleader action in appropriate circumstances. See Section 7-603.

4. If a warehouse has both a warehouse lien and a security interest, the warehouse may enforce both the lien and the security interest simultaneously by using the procedures of Article 9. Section 7-210 adopts

as its touchstone “commercial reasonableness” for the enforcement of a warehouse lien. Following the procedures of Article 9 satisfies “commercial reasonableness.”

Cross References: Sections 2-706, 7-403, 7-603, and Part 6 of Article 9.

Definitional Cross References: “Bill of lading”. Section 1-201.

“Conspicuous”. Section 1-201.

“Creditor”. Section 1-201.

“Delivery”. Section 1-201.

“Document of Title”. Section 1-201.

“Good faith”. Section 1-201 [7-102].

“Goods”. Section 7-102.

“Notification”. Section 1-202.

“Notifies”. Section 1-202.

“Person”. Section 1-201.

“Purchaser”. Section 1-201.

“Rights”. Section 1-201.

“Term”. Section 1-201.

“Warehouse”. Section 7-102.

Part 3
Bills of Lading — Special Provisions

• Title 28 •, « Ch. 7 », « Pt. 3 », • § 28-7-301 »

Idaho Code § 28-7-301

§ 28-7-301. Liability for nonreceipt or misdescription — "Said to contain" — "Shipper's weight, load, and count" — Improper handling. — (a) A consignee of a nonnegotiable bill of lading which has given value in good faith, or a holder to which a negotiable bill has been duly negotiated, relying upon the description of the goods in the bill or upon the date shown in the bill, may recover from the issuer damages caused by the misdating of the bill or the nonreceipt or misdescription of the goods, except to the extent that the bill indicates that the issuer does not know whether any part or all of the goods in fact were received or conform to the description, such as in a case in which the description is in terms of marks or labels or kind, quantity, or condition or the receipt or description is qualified by "contents or condition of contents of packages unknown," "said to contain," "shipper's weight, load, and count," or words of similar import, if that indication is true.

(b) If goods are loaded by the issuer of a bill of lading: (1) The issuer shall count the packages of goods if shipped in packages and ascertain the kind and quantity if shipped in bulk; and (2) Words such as "shipper's weight, load, and count," or words of similar import indicating that the description was made by the shipper are ineffective except as to goods concealed in packages.

(c) If bulk goods are loaded by a shipper that makes available to the issuer of a bill of lading adequate facilities for weighing those goods, the issuer shall ascertain the kind and quantity within a reasonable time after receiving the shipper's request in a record to do so. In that case, "shipper's weight" or words of similar import are ineffective.

(d) The issuer of a bill of lading, by including in the bill the words "shipper's weight, load, and count," or words of similar import, may indicate that the goods were loaded by the shipper, and, if that statement is true, the issuer is not liable for damages caused by the improper loading.

However, omission of such words does not imply liability for damages caused by improper loading.

(e) A shipper guarantees to an issuer the accuracy at the time of shipment of the description, marks, labels, number, kind, quantity, condition, and weight, as furnished by the shipper, and the shipper shall indemnify the issuer against damage caused by inaccuracies in those particulars. This right of indemnity does not limit the issuer's responsibility or liability under the contract of carriage to any person other than the shipper.

History.

I.C., § 28-7-301, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-301, which comprised 1967, ch. 161, § 7-301, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 51.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-301.

Changes: Changes for clarity, style and to recognize deregulation in the transportation industry.

Purposes:

1. This section continues the rules from former Section 7-301 with one substantive change. The obligations of the issuer of the bill of lading under former subsections (2) and (3) were limited to issuers who were common carriers. Subsections (b) and (c) apply the same rules to all issuers not just common carriers. This section is compatible with the policies stated in the federal Bills of Lading Act, 49 U.S.C. § 80113 (2000).

2. The language of the pre-Code Uniform Bills of Lading Act suggested that a carrier is ordinarily liable for damage caused by improper loading, but may relieve itself of liability by disclosing on the bill that shipper actually loaded. A more accurate statement of the law is that the carrier is not liable for losses caused by act or default of the shipper, which would include improper loading. *D.H. Overmyer Co. v. Nelson Brantley Glass Co.*, 168 S.E.2d 176 (Ga. Ct. App. 1969). There was some question whether under pre-Code law a carrier was liable even to a good faith purchaser of a negotiable bill for such losses, if the shipper's faulty loading in fact caused the loss. Subsection (d) permits the carrier to bar, by disclosure of shipper's loading, liability to a good faith purchaser. There is no implication that decisions such as *Modern Tool Corp. v. Pennsylvania R. Co.*, 100 F. Supp. 595 (D.N.J. 1951), are disapproved.

3. This section is a restatement of existing law as to the method by which a bailee may avoid responsibility for the accuracy of descriptions which are made by or in reliance upon information furnished by the depositor or shipper. The wording in this section — "contents or condition of contents of packages unknown" or "shipper's weight, load and count" — to indicate that the shipper loaded the goods or that the carrier does not know the description, condition, or contents of the loaded packages continues to be appropriate as commonly understood in the transportation industry. The reasons for this wording are as important in 2002 as when the prior section initially was approved. The issuer is liable on documents issued by an agent, contrary to instructions of his principal, without receiving goods. No disclaimer of this liability is permitted since it is not a matter either of the care of the goods or their description.

4. The shipper's erroneous report to the carrier concerning the goods may cause damage to the carrier. Subsection (e) therefore provides appropriate indemnity.

5. The word "freight" in the former Section 7-301 has been changed to "goods" to conform to international and domestic land transport usage in which "freight" means the price paid for carriage of the goods and not the goods themselves. Hence, changing the word "freight" to the word "goods" is a clarifying change that fits both international and domestic practice.

Cross References: Sections 7-203, 7-309 and 7-501.

Definitional Cross References: "Bill of lading". Section 1-201.

"Consignee". Section 7-102.

"Document of Title". Section 1-201.

"Duly negotiate". Section 7-501.

"Good faith". Section 1-201 [7-102].

"Goods". Section 7-102.

"Holder". Section 1-201.

"Issuer". Section 7-102.

"Notice". Section 1-202.

"Party". Section 1-201.

"Purchaser". Section 1-201.

"Receipt of Goods". Section 2-103.

"Value". Section 1-204.

§ 28-7-302. Through bills of lading and similar documents of title. —

(a) The issuer of a through bill of lading, or other document of title embodying an undertaking to be performed in part by a person acting as its agent or by a performing carrier, is liable to any person entitled to recover on the bill or other document for any breach by the other person or the performing carrier of its obligation under the bill or other document. However, to the extent that the bill or other document covers an undertaking to be performed overseas or in territory not contiguous to the continental United States or an undertaking including matters other than transportation, this liability for breach by the other person or the performing carrier may be varied by agreement of the parties.

(b) If goods covered by a through bill of lading or other document of title embodying an undertaking to be performed in part by a person other than the issuer are received by that person, the person is subject, with respect to its own performance while the goods are in its possession, to the obligation of the issuer. The person's obligation is discharged by delivery of the goods to another person pursuant to the bill or other document and does not include liability for breach by any other person or by the issuer.

(c) The issuer of a through bill of lading or other document of title described in subsection (a) of this section is entitled to recover from the performing carrier, or other person in possession of the goods when the breach of the obligation under the bill or other document occurred: (1) The amount it may be required to pay to any person entitled to recover on the bill or other document for the breach, as may be evidenced by any receipt, judgment, or transcript of judgment; and (2) The amount of any expense reasonably incurred by the issuer in defending any action commenced by any person entitled to recover on the bill or other document for the breach.

History.

I.C., § 28-7-302, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-302, which comprised 1967, ch. 161, § 7-302, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-302.

Changes: To conform to current terminology and for style.

Purposes:

1. This section continues the rules from former Section 7-302 without substantive change. The term "performing carrier" is substituted for the term "connecting carrier" to conform the terminology of this section with terminology used in recent UNCITRAL and OAS proposals concerning transportation and through bills of lading. This change in terminology is not substantive. This section is compatible with liability on carriers under federal law. See 49 U.S.C. §§ 11706, 14706 and 15906.

The purpose of this section is to subject the initial carrier under a through bill to suit for breach of the contract of carriage by any performing carrier and to make it clear that any such performing carrier holds the goods on terms which are defined by the document of title even though such performing carrier did not issue the document. Since the performing carrier does hold the goods on the terms of the document, it must honor a proper demand for delivery or a diversion order just as the original bailee would have to. Similarly it has the benefits of the excuses for non-delivery and limitations of liability provided for the original bailee who issued the bill. Unlike the original bailee-issuer, the performing carrier's responsibility is limited to the period while the goods are in its possession. The section does not impose any obligation to issue through bills.

2. The reference to documents other than through bills looks to the possibility that multi-purpose documents may come into use, e.g., combination warehouse receipts and bills of lading. As electronic documents of title come into common usage, storage documents (e.g., warehouse receipts) and transportation documents (e.g., bills of lading) may merge seamlessly into one electronic document that can serve both the storage and transportation segments of the movement of goods.

3. Under subsection (a) the issuer of a through bill of lading may become liable for the fault of another person. Subsection (c) gives the issuer appropriate rights of recourse.

4. Despite the broad language of subsection (a), Section 7-302 is subject to preemption by federal laws and treaties. Section 7-103. The precise scope of federal preemption in the transportation sector is a question determined under federal law.

Cross Reference: Section 7-103.

Definitional Cross References: "Agreement". Section 1-201.

"Bailee". Section 7-102.

"Bill of lading". Section 1-201.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Party". Section 1-201.

"Person". Section 1-201.

§ 28-7-303. Diversion — Reconsignment — Change of instructions. — (a) Unless the bill of lading otherwise provides, a carrier may deliver the goods to a person or destination other than that stated in the bill or may otherwise dispose of the goods, without liability for misdelivery, on instructions from:

(1) The holder of a negotiable bill; (2) The consignor on a nonnegotiable bill, even if the consignee has given contrary instructions; (3) The consignee on a nonnegotiable bill in the absence of contrary instructions from the consignor, if the goods have arrived at the billed destination or if the consignee is in possession of the tangible bill or in control of the electronic bill; or (4) The consignee on a nonnegotiable bill, if the consignee is entitled as against the consignor to dispose of the goods.

(b) Unless instructions described in subsection (a) of this section are included in a negotiable bill of lading, a person to which the bill is duly negotiated may hold the bailee according to the original terms.

History.

I.C., § 28-7-303, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-303, which comprised 1967, ch. 161, § 7-303, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-303.

Changes: To accommodate electronic documents and for style.

Purposes: 1. Diversion is a very common commercial practice which defeats delivery to the consignee originally named in a bill of lading. This section continues former Section 7-303's safe harbor rules for carriers in situations involving diversion and adapts those rules to electronic

documents of title. This section works compatibly with Section 2-705. Carriers may as a business matter be willing to accept instructions from consignees in which case the carrier will be liable for misdelivery if the consignee was not the owner or otherwise empowered to dispose of the goods under subsection (a)(4). The section imposes no duty on carriers to undertake diversion. The carrier is of course subject to the provisions of mandatory filed tariffs as provided in Section 7-103.

2. It should be noted that the section provides only an immunity for carriers against liability for "misdelivery." It does not, for example, defeat the title to the goods which the consignee-buyer may have acquired from the consignor-seller upon delivery of the goods to the carrier under a nonnegotiable bill of lading. Thus if the carrier, upon instructions from the consignor, returns the goods to the consignor, the consignee may recover the goods from the consignor or the consignor's insolvent estate. However, under certain circumstances, the consignee's title may be defeated by diversion of the goods in transit to a different consignee. The rights that arise between the consignor-seller and the consignee-buyer out of a contract for the sale of goods are governed by Article 2.

Cross References: Point 1: Sections 2-705 and 7-103.

Point 2: Article 2, Sections 7-403 and 7-504(3).

Definitional Cross References: "Bailee". Section 7-102.

"Bill of lading". Section 1-201.

"Carrier". Section 7-102.

"Consignee". Section 7-102.

"Consignor". Section 7-102.

"Delivery". Section 1-201.

"Goods". Section 7-102.

"Holder". Section 1-201.

"Notice". Section 1-202.

"Person". Section 1-201.

"Purchaser". Section 1-201.

“Term”. Section 1-201.

§ 28-7-304. Tangible bills of lading in a set. — (a) Except as customary in international transportation, a tangible bill of lading may not be issued in a set of parts. The issuer is liable for damages caused by violation of this subsection.

(b) If a tangible bill of lading is lawfully issued in a set of parts, each of which contains an identification code and is expressed to be valid only if the goods have not been delivered against any other part, the whole of the parts constitutes one (1) bill.

(c) If a tangible negotiable bill of lading is lawfully issued in a set of parts and different parts are negotiated to different persons, the title of the holder to which the first due negotiation is made prevails as to both the document of title and the goods even if any later holder may have received the goods from the carrier in good faith and discharged the carrier's obligation by surrendering its part.

(d) A person that negotiates or transfers a single part of a tangible bill of lading issued in a set is liable to holders of that part as if it were the whole set.

(e) The bailee shall deliver in accordance with part 4 of this chapter against the first presented part of a tangible bill of lading lawfully issued in a set. Delivery in this manner discharges the bailee's obligation on the whole bill.

History.

I.C., § 28-7-304, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-304, which comprised 1967, ch. 161, § 7-304, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 42 et seq.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-304.

Changes: To limit bills in a set to tangible bills of lading and to use terminology more consistent with modern usage.

Purposes:

1. Tangible bills of lading in a set are still used in some nations in international trade. Consequently, a tangible bill of lading part of a set could be at issue in a lawsuit that might come within Article 7. The statement of the legal effect of a lawfully issued set is in accord with existing commercial law relating to maritime and other international tangible bills of lading. This law has been codified in the Hague and Warsaw Conventions and in the Carriage of Goods by Sea Act, the provisions of which would ordinarily govern in situations where bills in a set are recognized by this Article. Tangible bills of lading in a set are prohibited in domestic trade.

2. Electronic bills of lading in domestic or international trade will not be issued in a set given the requirements of control necessary to deliver the bill to another person. An electronic bill of lading will be a single, authoritative copy. Section 7-106. Hence, this section differentiates between electronic bills of lading and tangible bills of lading. This section does not prohibit electronic data messages about goods in transit because these electronic data messages are not the issued bill of lading. Electronic data messages contain information for the carrier's management and handling of the cargo but this information for the carrier's use is not the issued bill of lading.

Cross References: Sections 7-103, 7-303 and 7-106.

Definitional Cross References: "Bailee". Section 7-102.

"Bill of lading". Section 1-201.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Good faith". Section 1-201 [7-102].

"Goods". Section 7-102.

"Holder". Section 1-201.

"Issuer". Section 7-102.

"Person". Section 1-201.

"Receipt of goods". Section 2-103.

§ 28-7-305. Destination bills. — (a) Instead of issuing a bill of lading to the consignor at the place of shipment, a carrier, at the request of the consignor, may procure the bill to be issued at destination or at any other place designated in the request.

(b) Upon request of any person entitled as against a carrier to control the goods while in transit and on surrender of possession or control of any outstanding bill of lading or other receipt covering the goods, the issuer, subject to section 28-7-105[, Idaho Code], may procure a substitute bill to be issued at any place designated in the request.

History.

I.C., § 28-7-305, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-305, which comprised 1967, ch. 161, § 7-305, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertion in subsection (b) was added by the compiler to conform to the statutory citation style.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-305.

Changes: To accommodate electronic bills of lading and for style.

Purposes: 1. Subsection (a) continues the rules of former Section 7-305(1) without substantive change. This proposal is designed to facilitate the use of order bills in connection with fast shipments. Use of order bills on high speed shipments is impeded by the fact that the goods may arrive at destination before the documents, so that no one is ready to take delivery from the carrier. This is especially inconvenient for carriers by truck and air, who do not have terminal facilities where shipments can be held to await

the consignee's appearance. Order bills would be useful to take advantage of bank collection. This may be preferable to C.O.D. shipment in which the carrier, e.g., a truck driver, is the collecting and remitting agent. Financing of shipments under this plan would be handled as follows: seller at San Francisco delivers the goods to an airline with instructions to issue a bill in New York to a named bank. Seller receives a receipt embodying this undertaking to issue a destination bill. Airline wires its New York freight agent to issue the bill as instructed by the seller. Seller wires the New York bank a draft on buyer. New York bank indorses the bill to buyer when the buyer honors the draft. Normally seller would act through its own bank in San Francisco, which would extend credit in reliance on the airline's contract to deliver a bill to the order of its New York correspondent. This section is entirely permissive; it imposes no duty to issue such bills. Whether a performing carrier will act as issuing agent is left to agreement between carriers.

2. Subsection (b) continues the rule from former Section 7-305(2) with accommodation for electronic bills of lading. If the substitute bill changes from an electronic to a tangible medium or vice versa, the issuance of the substitute bill must comply with Section 7-105 to give the substitute bill validity and effect.

Cross Reference: Section 7-105.

Definitional Cross References: "Bill of lading". Section 1-201.

"Consignor". Section 7-102.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Receipt of goods". Section 2-103.

§ 28-7-306. Altered bills of lading. — An unauthorized alteration or filling in of a blank in a bill of lading leaves the bill enforceable according to its original tenor.

History.

I.C., § 28-7-306, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-306, which comprised 1967, ch. 161, § 7-306, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 34 et seq.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-306.

Changes: None.

Purposes: An unauthorized alteration or filling in of a blank, whether made with or without fraudulent intent, does not relieve the issuer of its liability on the document as originally executed. This section applies to both tangible and electronic bills of lading, applying the same rule to both types of bills of lading. The control concept of Section 7-106 requires that any changes to the electronic document of title be readily identifiable as authorized or unauthorized. Section 7-306 should be compared to Section 7-208 where a different rule applies to the unauthorized filling in of a blank for tangible warehouse receipts.

Cross References: Sections 7-106 and 7-208.

Definitional Cross References: "Bill of lading". Section 1-201.

"Issuer". Section 7-102.

§ 28-7-307. Lien of carrier. — (a) A carrier has a lien on the goods covered by a bill of lading or on the proceeds thereof in its possession for charges after the date of the carrier's receipt of the goods for storage or transportation, including demurrage and terminal charges, and for expenses necessary for preservation of the goods incident to their transportation or reasonably incurred in their sale pursuant to law. However, against a purchaser for value of a negotiable bill of lading, a carrier's lien is limited to charges stated in the bill or the applicable tariffs or, if no charges are stated, a reasonable charge.

(b) A lien for charges and expenses under subsection (a) of this section on goods that the carrier was required by law to receive for transportation is effective against the consignor or any person entitled to the goods unless the carrier had notice that the consignor lacked authority to subject the goods to those charges and expenses. Any other lien under subsection (a) of this section is effective against the consignor and any person that permitted the bailor to have control or possession of the goods unless the carrier had notice that the bailor lacked authority.

(c) A carrier loses its lien on any goods that it voluntarily delivers or unjustifiably refuses to deliver.

History.

I.C., § 28-7-307, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-307, which comprised 1967, ch. 161, § 7-307, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-307.

Changes: Expanded to cover proceeds of the goods transported.

Purposes: 1. The section is intended to give carriers a specific statutory lien for charges and expenses similar to that given to warehouses by the first sentence of Section 7-209(a) and extends that lien to the proceeds of the goods as long as the carrier has possession of the proceeds. But because carriers do not commonly claim a lien for charges in relation to other goods or lend money on the security of goods in their hands, provisions for a general lien or a security interest similar to those in Section 7-209(a) and (b) are omitted. Carriers may utilize Article 9 to obtain a security interest and become a secured party or a carrier may agree to limit its lien rights in a transportation agreement with the shipper. As the lien given by this section is specific, and the storage or transportation often preserves or increases the value of the goods, subsection (b) validates the lien against anyone who permitted the bailor to have possession of the goods. Where the carrier is required to receive the goods for transportation, the owner's interest may be subjected to charges and expenses arising out of deposit of his goods by a thief. The crucial mental element is the carrier's knowledge or reason to know of the bailor's lack of authority. If the carrier does not know or have reason to know of the bailor's lack of authority, the carrier has a lien under this section against any person so long as the conditions of subsection (b) are satisfied. In light of the crucial mental element, Sections 7-307 and 9-333 combine to give priority to a carrier's lien over security interests in the goods. In this regard, the judicial decision in *In re Sharon Steel Corp.*, 25 U.C.C. Rep.2d 503, 176 B.R. 384 (W.D. Pa. 1995) is correct and is the controlling precedent.

2. The reference to charges in this section means charges relating to the bailment relationship for transportation. Charges does not mean that the bill of lading must state a specific rate or a specific amount. However, failure to state a specific rate or a specific amount has legal consequences under the second sentence of subsection (a).

3. The carrier's specific lien under this section is a possessory lien. See subsection (c). Part 3 of Article 7 does not require any particular form for a bill of lading. The carrier's lien arises when the carrier has issued a bill of lading.

Cross References: Point 1: Sections 7-209, 9-109 and 9-333.

Point 3: Sections 7-202 and 7-209.

Definitional Cross References: "Bill of lading". Section 1-201.

"Carrier". Section 7-102.

"Consignor". Section 7-102.

"Delivery". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Value". Section 1-204.

§ 28-7-308. Enforcement of carrier's lien. — (a) A carrier's lien on goods may be enforced by public or private sale of the goods, in bulk or in packages, at any time or place and on any terms that are commercially reasonable, after notifying all persons known to claim an interest in the goods. The notification must include a statement of the amount due, the nature of the proposed sale, and the time and place of any public sale. The fact that a better price could have been obtained by a sale at a different time or in a method different from that selected by the carrier is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner. The carrier sells goods in a commercially reasonable manner if the carrier sells the goods in the usual manner in any recognized market therefor, sells at the price current in that market at the time of the sale, or otherwise sells in conformity with commercially reasonable practices among dealers in the type of goods sold. A sale of more goods than apparently necessary to be offered to ensure satisfaction of the obligation is not commercially reasonable, except in cases covered by the preceding sentence.

(b) Before any sale pursuant to this section, any person claiming a right in the goods may pay the amount necessary to satisfy the lien and the reasonable expenses incurred in complying with this section. In that event, the goods may not be sold but must be retained by the carrier, subject to the terms of the bill of lading and this chapter.

(c) A carrier may buy at any public sale pursuant to this section.

(d) A purchaser in good faith of goods sold to enforce a carrier's lien takes the goods free of any rights of persons against which the lien was valid, despite the carrier's noncompliance with this section.

(e) A carrier may satisfy its lien from the proceeds of any sale pursuant to this section but shall hold the balance, if any, for delivery on demand to any person to which the carrier would have been bound to deliver the goods.

(f) The rights provided by this section are in addition to all other rights allowed by law to a creditor against a debtor.

(g) A carrier's lien may be enforced pursuant to either subsection (a) of this section or the procedure set forth in section 28-7-210(b)[, Idaho Code].

(h) A carrier is liable for damages caused by failure to comply with the requirements for sale under this section and, in case of willful violation, is liable for conversion.

History.

I.C., § 28-7-308, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-308, which comprised 1967, ch. 161, § 7-308, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertion at the end of subsection (g) was added by the compiler to conform to the statutory citation style.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-308.

Changes: To conform language to modern usage and for style.

Purposes: This section is intended to give the carrier an enforcement procedure of its lien coextensive with that given the warehouse in cases other than those covering noncommercial storage by the warehouse. See Section 7-210 and comments.

Cross Reference: Section 7-210.

Definitional Cross References: "Bill of lading". Section 1-201.

"Carrier". Section 7-102.

"Creditor". Section 1-201.

"Delivery". Section 1-201.

"Good faith". Section 1-201 [7-102].

"Goods". Section 7-102.

"Notification". Section 1-202.

"Notifies". Section 1-202.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Rights". Section 1-201.

"Term". Section 1-201.

§ 28-7-309. Duty of care — Contractual limitation of carrier's liability.

— (a) A carrier that issues a bill of lading, whether negotiable or nonnegotiable, shall exercise the degree of care in relation to the goods which a reasonably careful person would exercise under similar circumstances. This subsection does not affect any statute, regulation, or rule of law that imposes liability upon a common carrier for damages not caused by its negligence.

(b) Damages may be limited by a term in the bill of lading or in a transportation agreement that the carrier's liability may not exceed a value stated in the bill or transportation agreement if the carrier's rates are dependent upon value and the consignor is afforded an opportunity to declare a higher value and the consignor is advised of the opportunity. However, such a limitation is not effective with respect to the carrier's liability for conversion to its own use.

(c) Reasonable provisions as to the time and manner of presenting claims and commencing actions based on the shipment may be included in a bill of lading or a transportation agreement.

History.

I.C., § 28-7-309, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-309, which comprised 1967, ch. 161, § 7-309, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law Liability.

Bill of lading stating that carrier shall not be liable for any loss or damage by fire was void as against shipper unless it be shown by other evidence that there was a consideration for such exemption. McIntosh v. Oregon R.R. & Nav. Co., 17 Idaho 100, 105 P. 66 (1909).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 47.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-309.

Changes: References to tariffs eliminated because of deregulation, adding reference to transportation agreements, and for style.

Purposes: 1. A bill of lading may also serve as the contract between the carrier and the bailor. Parties in their contract should be able to limit the amount of damages for breach of that contract including breach of the duty to take reasonable care of the goods. The parties cannot disclaim by contract the carrier's obligation of care. Section 1-302.

Federal statutes and treaties for air, maritime and rail transport may alter the standard of care. These federal statutes and treaties preempt this section when applicable. Section 7-103. Subsection (a) does not impair any rule of law imposing the liability of an insurer on a common carrier in intrastate commerce. Subsection (b), however, applies to the common carrier's liability as an insurer as well as to liability based on negligence. Subsection (b) allows the term limiting damages to appear either in the bill of lading or in the parties' transportation agreement. Compare 7-204(b). Subsection (c) allows the parties to agree to provisions regarding time and manner of presenting claims or commencing actions if the provisions are either in the bill of lading or the transportation agreement. Compare 7-204(c). Transportation agreements are commonly used to establish agreed terms between carriers and shippers that have an on-going relationship.

2. References to public tariffs in former Section 7-309(2) and (3) have been deleted in light of the modern era of deregulation. See Comment 2 to Section 7-103. If a tariff is required under state or federal law, pursuant to Section 7-103(a), the tariff would control over the rule of this section. As governed by contract law, parties may incorporate by reference the limits on the amount of damages or the reasonable provisions as to the time and manner of presenting claims set forth in applicable tariffs, e.g., a maximum unit value beyond which goods are not taken or a disclaimer of responsibility for undeclared articles of extraordinary value.

3. As under former Section 7-309(2), subsection (b) provides that a limitation of damages is ineffective if the carrier has converted the goods to its own use. A mere failure to redeliver the goods is not conversion to the carrier's own use. "Conversion to its own use" is narrower than the idea of conversion generally. *Art Masters Associates, Ltd. v. United Parcel Service*, 77 N.Y.2d 200, 567 N.E.2d 226 (1990); *See, Kemper Ins. Co. v. Fed. Ex. Corp.*, 252 F.3d 509 (1st Cir.), *cert. denied,* 534 U.S. 1020 (2001) (opinion interpreting federal law).

4. As used in this section, damages may include damages arising from delay in delivery. Delivery dates and times are often specified in the parties' contract. See Section 7-403.

Cross References: Sections 1-302, 7-103, 7-204, and 7-403.

Definitional Cross References: "Action". Section 1-201.

"Bill of lading". Section 1-201.

"Carrier". Section 7-102.

"Consignor". Section 7-102.

"Document of Title". Section 1-102.

"Goods". Section 7-102.

"Value". Section 1-204.

Part 4
Warehouse Receipts and Bills of Lading — General Obligations

Idaho Code § 28-7-401

§ 28-7-401. Irregularities in issue of receipt or bill or conduct of issuer.

— The obligations imposed by this chapter on an issuer apply to a document of title even if:

(1) The document does not comply with the requirements of this chapter or of any other statute, rule, or regulation regarding its issuance, form, or content; (2) The issuer violated laws regulating the conduct of its business; (3) The goods covered by the document were owned by the bailee when the document was issued; or (4) The person issuing the document is not a warehouse but the document purports to be a warehouse receipt.

History.

I.C., § 28-7-401, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-401, which comprised 1967, ch. 161, § 7-401, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law Defective Receipt No Defense.

Where party was charged with the unlawful sale of grain stored in his warehouse, he should not be heard in his defense to urge that a warehouse receipt issued by him for grain received and stored was not in form and substance as required to be issued by provisions of the statute. State v. Henzell, 17 Idaho 725, 107 P. 67 (1910).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 46.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-401.

Changes: Changes for style only.

Purposes: The bailee's liability on its document despite non-receipt or misdescription of the goods is affirmed in Sections 7-203 and 7-301. The purpose of this section is to make it clear that regardless of irregularities a document which falls within the definition of document of title imposes on the issuer the obligations stated in this Article. For example, a bailee will not be permitted to avoid its obligation to deliver the goods (Section 7-403) or its obligation of due care with respect to them (Sections 7-204 and 7-309) by taking the position that no valid "document" was issued because it failed to file a statutory bond or did not pay stamp taxes or did not disclose the place of storage in the document. Tate v. Action Moving & Storage, Inc., 383 S.E.2d 229 (N.C. App. 1989), *rev. denied,* 389 S.E.2d 104 (N.C. 1990). Sanctions against violations of statutory or administrative duties with respect to documents should be limited to revocation of license or other measures prescribed by the regulation imposing the duty. See Section 7-103.

Cross References: Sections 7-103, 7-203, 7-204, 7-301, and 7-309.

Definitional Cross References: "Bailee". Section 7-102.

"Document of title". Section 1-201.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Person". Section 1-201.

"Warehouse receipt". Section 1-201.

"Warehouse". Section 7-102.

§ 28-7-402. Duplicate document of title — Overissue. — A duplicate or any other document of title purporting to cover goods already represented by an outstanding document of the same issuer does not confer any right in the goods, except as provided in the case of tangible bills of lading in a set of parts, overissue of documents for fungible goods, substitutes for lost, stolen, or destroyed documents, or substitute documents issued pursuant to section 28-7-105[, Idaho Code]. The issuer is liable for damages caused by its overissue or failure to identify a duplicate document by a conspicuous notation.

History.

I.C., § 28-7-402, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-402, which comprised 1967, ch. 161, § 7-402, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertion at the end of the first sentence was added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 43.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-402.

Changes: Changes to accommodate electronic documents.

Purposes: 1. This section treats a duplicate which is not properly identified as a duplicate like any other overissue of documents: a purchaser of such a document acquires no title but only a cause of action for damages

against the person that made the deception possible, except in the cases noted in the section. But parts of a tangible bill lawfully issued in a set of parts are not “overissue” (Section 7-304). Of course, if the issuer has clearly indicated that a document is a duplicate so that no one can be deceived by it, and in fact the duplicate is a correct copy of the original, the issuer is not liable for preparing and delivering such a duplicate copy.

Section 7-105 allows documents of title to be reissued in another medium. Reissuance of a document in an alternative medium under Section 7-105 requires that the original document be surrendered to the issuer in order to make the substitute document the effective document. If the substitute document is not issued in compliance with Section 7-105, then the document should be treated as a duplicate under this section.

2. The section applies to nonnegotiable documents to the extent of providing an action for damages for one who acquires an unmarked duplicate from a transferor who knew the facts and would therefore have had no cause of action against the issuer of the duplicate. Ordinarily the transferee of a nonnegotiable document acquires only the rights of its transferor.

3. Overissue is defined so as to exclude the common situation where two valid documents of different issuers are outstanding for the same goods at the same time. Thus freight forwarders commonly issue bills of lading to their customers for small shipments to be combined into carload shipments for which the railroad will issue a bill of lading to the forwarder. So also a warehouse receipt may be outstanding against goods, and the holder of the receipt may issue delivery orders against the same goods. In these cases dealings with the subsequently issued documents may be effective to transfer title; e.g., negotiation of a delivery order will effectively transfer title in the ordinary case where no dishonesty has occurred and the goods are available to satisfy the orders. Section 7-503 provides for cases of conflict between documents of different issuers.

Cross References: Point 1: Sections 7-105, 7-207, 7-304, and 7-601.

Point 3: Section 7-503.

Definitional Cross References: “Bill of lading”. Section 1-201.

“Conspicuous”. Section 1-201.

"Document of title". Section 1-201.

"Fungible goods". Section 1-201.

"Goods". Section 7-102.

"Issuer". Section 7-102.

"Right". Section 1-201.

§ 28-7-403. Obligation of bailee to deliver — Excuse. — (a) A bailee shall deliver the goods to a person entitled under a document of title if the person complies with subsections (b) and (c) of this section, unless and to the extent that the bailee establishes any of the following:

(1) Delivery of the goods to a person whose receipt was rightful as against the claimant; (2) Damage to or delay, loss, or destruction of the goods for which the bailee is not liable; (3) Previous sale or other disposition of the goods in lawful enforcement of a lien or on a warehouse's lawful termination of storage; (4) The exercise by a seller of its right to stop delivery pursuant to section 28-2-705[, Idaho Code,] or by a lessor of its right to stop delivery pursuant to section 28-12-526[, Idaho Code]; (5) A diversion, reconsignment, or other disposition pursuant to section 28-7-303[, Idaho Code]; (6) Release, satisfaction, or any other personal defense against the claimant; or (7) Any other lawful excuse.

(b) A person claiming goods covered by a document of title shall satisfy the bailee's lien if the bailee so requests or if the bailee is prohibited by law from delivering the goods until the charges are paid.

(c) Unless a person claiming the goods is a person against which the document of title does not confer a right under section 28-7-503(a)[, Idaho Code]: (1) The person claiming under a document shall surrender possession or control of any outstanding negotiable document covering the goods for cancellation or indication of partial deliveries; and (2) The bailee shall cancel the document or conspicuously indicate in the document the partial delivery or the bailee is liable to any person to which the document is duly negotiated.

History.

I.C., § 28-7-403, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-403, which comprised 1967, ch. 161, § 7-403, p. 351, am. 1982, ch. 310, § 1, p. 775, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertions in paragraphs (a)(4) and (a)(5) and in the introductory paragraph in subsection (c) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Burden of Proof.

An instruction to the jury that once the bailor established delivery of the goods the burden of proof was on the bailee to establish the existence of a lawful excuse for nondelivery was not error. Duthie v. Shepherd, 32 Idaho 633, 186 P. 919 (1920).

A warehouseman who was unable to deliver goods had the burden of proving that he exercised due care. Shockley v. Tennyson Transf. & Storage, Inc., 76 Idaho 131, 278 P.2d 795 (1955).

In enacting an earlier version of this section, the legislature indicated that, as a matter of policy, the burden of establishing negligence should not be placed on the bailor. Low v. Park Price Co., 95 Idaho 91, 503 P.2d 291 (1972).

Intent Not Material.

Under a former statute, in a prosecution of a warehouseman for unlawfully selling stored grain, the motive or intent with which the sale was made was immaterial and constituted no defense. State v. Henzell, 17 Idaho 725, 107 P. 67 (1910).

Lack of Due Care.

Determination by trial court that warehouseman had failed to show that fire was not due to his negligence or lack of due care was in substance a finding of lack of required care. Shockley v. Tennyson Transf. & Storage, Inc., 76 Idaho 131, 278 P.2d 795 (1955).

Surrender of Receipt.

The goods covered by the warehouse receipts could not be delivered by the warehouseman without surrender to him of the receipts as the goods follow and are subordinate to the receipt, not vice-versa. Venus Foods v. District Court, 67 Idaho 390, 181 P.2d 775 (1947).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 60 et seq.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-403.

Changes: Definition in former Section 7-403(4) moved to Section 7-102; bracketed language in former Section 7-403(1)(b) deleted; added cross reference to Section 2A-526; changes for style.

Purposes:

1. The present section, following former Section 7-403, is constructed on the basis of stating what previous deliveries or other circumstances operate to excuse the bailee's normal obligation on the document. Accordingly, "justified" deliveries under the pre-Code uniform acts now find their place as "excuse" under subsection (a).

2. The principal case covered by subsection (a)(1) is delivery to a person whose title is paramount to the rights represented by the document. For example, if a thief deposits stolen goods in a warehouse facility and takes a negotiable receipt, the warehouse is not liable on the receipt if it has surrendered the goods to the true owner, even though the receipt is held by a good faith purchaser. See Section 7-503(a). However, if the owner entrusted the goods to a person with power of disposition, and that person deposited the goods and took a negotiable document, the owner receiving delivery would not be rightful as against a holder to whom the negotiable document

was duly negotiated, and delivery to the owner would not give the bailee a defense against such a holder. See Sections 7-502(a)(2), 7-503(a)(1).

3. Subsection (a)(2) amounts to a cross reference to all the tort law that determines the varying responsibilities and standards of care applicable to commercial bailees. A restatement of this tort law would be beyond the scope of this Act. Much of the applicable law as to responsibility of bailees for the preservation of the goods and limitation of liability in case of loss has been codified for particular classes of bailees in interstate and foreign commerce by federal legislation and treaty and for intrastate carriers and other bailees by the regulatory state laws preserved by Section 7-103. In the absence of governing legislation the common law will prevail subject to the minimum standard of reasonable care prescribed by Sections 7-204 and 7-309 of this Article.

The bracketed language found in former Section 7-403(1)(b) has been deleted thereby leaving the allocations of the burden of going forward with the evidence and the burden of proof to the procedural law of the various states.

Subsection (a)(4) contains a cross reference to both the seller's and the lessor's rights to stop delivery under Article 2 and Article 2A, respectively.

4. As under former Section 7-403, there is no requirement that a request for delivery must be accompanied by a formal tender of the amount of the charges due. Rather, the bailee must request payment of the amount of its lien when asked to deliver, and only in case this request is refused is it justified in declining to deliver because of nonpayment of charges. Where delivery without payment is forbidden by law, the request is treated as implicit. Such a prohibition reflects a policy of uniformity to prevent discrimination by failure to request payment in particular cases. Subsection (b) must be read in conjunction with the priorities given to the warehouse lien and the carrier lien under Sections 7-209 and 7-307, respectively. If the parties are in dispute about whether the request for payment of the lien is legally proper, the bailee may have recourse to interpleader. See Section 7-603.

5. Subsection (c) states the obvious duty of a bailee to take up a negotiable document or note partial deliveries conspicuously thereon, and the result of failure in that duty. It is subject to only one exception, that

stated in subsection (a)(1) of this section and in Section 7-503(a). Subsection (c) is limited to cases of delivery to a claimant; it has no application, for example, where goods held under a negotiable document are lawfully sold to enforce the bailee's lien.

6. When courts are considering subsection (a)(7), "any other lawful excuse," among others, refers to compliance with court orders under Sections 7-601, 7-602 and 7-603.

Cross References:

Point 2: Sections 7-502 and 7-503.

Point 3: Sections 2-705, 2A-526, 7-103, 7-204, 7-309, and 10-103.

Point 4: Sections 7-209, 7-307, and 7-603.

Point 5: Section 7-503(1).

Point 6: Sections 7-601, 7-602, and 7-603.

Definitional Cross References:

"Bailee". Section 7-102.

"Conspicuous". Section 1-201.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Goods". Section 7-102.

"Lessor". Section 2A-103.

"Person". Section 1-201.

"Receipt of goods". Section 2-103.

"Right". Section 1-201.

"Terms". Section 1-201.

"Warehouse". Section 7-102.

§ 28-7-404. No liability for good-faith delivery pursuant to document of title. — A bailee that in good faith has received goods and delivered or otherwise disposed of the goods according to the terms of a document of title or pursuant to this chapter is not liable for the goods even if:

(1) The person from which the bailee received the goods did not have authority to procure the document or to dispose of the goods; or (2) The person to which the bailee delivered the goods did not have authority to receive the goods.

History.

I.C., § 28-7-404, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-404, which comprised 1967, ch. 161, § 7-404, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-404.

Changes: Changes reflect the definition of good faith in Section 1-201 [7-102] and for style.

Purposes: This section uses the test of good faith, as defined in Section 1-201 [7-102], to continue the policy of former Section 7-404. Good faith now means "honesty in fact and the observance of reasonable commercial standards of fair dealing." The section states explicitly that the common law rule of "innocent conversion" by unauthorized "intermeddling" with another's property is inapplicable to the operations of commercial carriers and warehousemen that in good faith perform obligations that they have assumed and that generally they are under a legal compulsion to assume. The section applies to delivery to a fraudulent holder of a valid document as well as to delivery to the holder of an invalid document. Of course, in

appropriate circumstances, a bailee may use interpleader or other dispute resolution process. See Section 7-603.

Cross Reference: Section 7-603.

Definitional Cross References: “Bailee”. Section 7-102.

“Delivery”. Section 1-201.

“Document of title”. Section 1-201.

“Good faith”. Section 1-201 [7-102].

“Goods”. Section 7-102.

“Person”. Section 1-201.

“Receipt of goods”. Section 2-103.

“Term”. Section 1-201.

Part 5
Warehouse Receipts and Bills of Lading — Negotiation and Transfer

• Title 28 •, « Ch. 7 », « Pt. 5 », • § 28-7-501 »

Idaho Code § 28-7-501

§ 28-7-501. Form of negotiation and requirements of due negotiation.

— (a) The following rules apply to a negotiable tangible document of title:

(1) If the document's original terms run to the order of a named person, the document is negotiated by the named person's indorsement and delivery. After the named person's indorsement in blank or to bearer, any person may negotiate the document by delivery alone.

(2) If the document's original terms run to bearer, it is negotiated by delivery alone.

(3) If the document's original terms run to the order of a named person and it is delivered to the named person, the effect is the same as if the document had been negotiated.

(4) Negotiation of the document after it has been indorsed to a named person requires indorsement by the named person and delivery.

(5) A document is duly negotiated if it is negotiated in the manner stated in this subsection to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves receiving the document in settlement or payment of a monetary obligation.

(b) The following rules apply to a negotiable electronic document of title:
(1) If the document's original terms run to the order of a named person or to bearer, the document is negotiated by delivery of the document to another person. Indorsement by the named person is not required to negotiate the document.

(2) If the document's original terms run to the order of a named person and the named person has control of the document, the effect is the same

as if the document had been negotiated.

(3) A document is duly negotiated if it is negotiated in the manner stated in this subsection to a holder that purchases it in good faith, without notice of any defense against or claim to it on the part of any person, and for value, unless it is established that the negotiation is not in the regular course of business or financing or involves taking delivery of the document in settlement or payment of a monetary obligation.

(c) Indorsement of a nonnegotiable document of title neither makes it negotiable nor adds to the transferee's rights.

(d) The naming in a negotiable bill of lading of a person to be notified of the arrival of the goods does not limit the negotiability of the bill or constitute notice to a purchaser of the bill of any interest of that person in the goods.

History.

I.C., § 28-7-501, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-501, which comprised 1967, ch. 161, § 7-501, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

CASE NOTES

Decisions Under Prior Law

Receipts Negotiable.

All checks or receipts given by any person operating a warehouse, commission house, forwarding house, mill, wharf or other place of storage for grain, flour, wool or other produce or commodity stored or deposited and all bills of lading and transportation receipts of any kind are negotiable and can be transferred by indorsement. State v. Henzell, 17 Idaho 725, 107 P. 67 (1910).

Warehouse receipts are negotiable and are assignable by indorsement, and such indorsement is a valid transfer of the commodity represented by

the receipts and can be made either in blank or to the order of another. Frontier Milling & Elevator Co. v. Roy White Coop. Mercantile Co., 25 Idaho 478, 138 P. 825 (1914).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 52 et seq.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-501.

Changes: To accommodate negotiable electronic documents of title.

Purposes:

1. Subsection (a) has been limited to tangible negotiable documents of title but otherwise remains unchanged in substance from the rules in former Section 7-501. Subsection (b) is new and applies to negotiable electronic documents of title. Delivery of a negotiable electronic document is through voluntary transfer of control. Section 1-201 definition of "delivery." The control concept as applied to negotiable electronic documents of title is the substitute for both possession and indorsement as applied to negotiable tangible documents of title. Section 7-106.

Article 7 does not separately define the term "duly negotiated." However, the elements of "duly negotiated" are set forth in subsection (a)(5) for tangible documents and (b)(3) for electronic documents. As under former Section 7-501, in order to effect a "due negotiation" the negotiation must be in the "regular course of business or financing" in order to transfer greater rights than those held by the person negotiating. The foundation of the mercantile doctrine of good faith purchase for value has always been, as shown by the case situations, the furtherance and protection of the regular course of trade. The reason for allowing a person, in bad faith or in error, to convey away rights which are not its own has from the beginning been to make possible the speedy handling of that great run of commercial transactions which are patently usual and normal.

There are two aspects to the usual and normal course of mercantile dealings, namely, the person making the transfer and the nature of the

transaction itself. The first question which arises is: Is the transferor a person with whom it is reasonable to deal as having full powers? In regard to documents of title the only holder whose possession or control appears, commercially, to be in order is almost invariably a person in the trade. No commercial purpose is served by allowing a tramp or a professor to "duly negotiate" an order bill of lading for hides or cotton not their own, and since such a transfer is obviously not in the regular course of business, it is excluded from the scope of the protection of subsections (a)(5) or (b)(3).

The second question posed by the "regular course" qualification is: Is the transaction one which is normally proper to pass full rights without inquiry, even though the transferor itself may not have such rights to pass, and even though the transferor may be acting in breach of duty? In raising this question the "regular course" criterion has the further advantage of limiting, the effective wrongful disposition to transactions whose protection will really further trade. Obviously, the snapping up of goods for quick resale at a price suspiciously below the market deserves no protection as a matter of policy: it is also clearly outside the range of regular course.

Any notice on the document sufficient to put a merchant on inquiry as to the "regular course" quality of the transaction will frustrate a "due negotiation." Thus irregularity of the document or unexplained staleness of a bill of lading may appropriately be recognized as negating a negotiation in "regular" course.

A pre-existing claim constitutes value, and "due negotiation" does not require "new value." A usual and ordinary transaction in which documents are received as security for credit previously extended may be in "regular" course, even though there is a demand for additional collateral because the creditor "deems himself insecure." But the matter has moved out of the regular course of financing if the debtor is thought to be insolvent, the credit previously extended is in effect cancelled, and the creditor snatches a plank in the shipwreck under the guise of a demand for additional collateral. Where a money debt is "paid" in commodity paper, any question of "regular" course disappears, as the case is explicitly excepted from "due negotiation."

2. Negotiation under this section may be made by any holder no matter how the holder acquired possession or control of the document.

3. Subsections (a)(3) and (b)(2) make explicit a matter upon which the intent of the pre-Code law was clear but the language somewhat obscure: a negotiation results from a delivery to a banker or buyer to whose order the document has been taken by the person making the bailment. There is no presumption of irregularity in such a negotiation; it may very well be in "regular course."

4. This Article does not contain any provision creating a presumption of due negotiation to, and full rights in, a holder of a document of title akin to that created by Uniform Commercial Code Article 3. But the reason of the provisions of this Act (Section 1-307) on the *prima facie* authenticity and accuracy of third party documents, joins with the reason of the present section to work such a presumption in favor of any person who has power to make a due negotiation. It would not make sense for this Act to authorize a purchaser to indulge the presumption of regularity if the courts were not also called upon to do so. Allocations of the burden of going forward with the evidence and the burden of proof are left to the procedural law of the various states.

5. Subsections (c) and (d) are unchanged from prior law and apply to both tangible and electronic documents of title.

Cross References:

Sections 1-307, 7-502 and 7-503.

Definitional Cross References: "Bearer". Section 1-201.

"Control". Section 7-106.

"Delivery". Section 1-201.

"Document of Title.". Section 1-201.

"Good faith". Section 1-201 [7-102].

"Holder". Section 1-201.

"Notice". Section 1-202.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Rights". Section 1-201.

"Term". Section 1-201.

"Value". Section 1-204.

§ 28-7-502. Rights acquired by due negotiation. — (a) Subject to sections 28-7-205 and 28-7-503[, Idaho Code], a holder to which a negotiable document of title has been duly negotiated acquires thereby:

(1) Title to the document; (2) Title to the goods;

(3) All rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and (4) The direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by the issuer except those arising under the terms of the document or under this chapter, but in the case of a delivery order, the bailee's obligation accrues only upon the bailee's acceptance of the delivery order and the obligation acquired by the holder is that the issuer and any indorser will procure the acceptance of the bailee.

(b) Subject to section 28-7-503[, Idaho Code], title and rights acquired by due negotiation are not defeated by any stoppage of the goods represented by the document of title or by surrender of the goods by the bailee and are not impaired even if: (1) The due negotiation or any prior due negotiation constituted a breach of duty; (2) Any person has been deprived of possession of a negotiable tangible document or control of a negotiable electronic document by misrepresentation, fraud, accident, mistake, duress, loss, theft, or conversion; or (3) A previous sale or other transfer of the goods or document has been made to a third person.

History.

I.C., § 28-7-502, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-502, which comprised 1967, ch. 161, § 7-502, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertions in the introductory paragraphs in subsections (a) and (b) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Good faith and value.

Symbolic delivery.

Good Faith and Value.

Mortgagee of personal property under mortgage securing antecedent debt was held an encumbrancer both in good faith and for value holding a lien superior to claim of purchaser of such property who had not removed it from seller's premises. Millick v. Stevens, 44 Idaho 347, 257 P. 30 (1927).

Symbolic Delivery.

The negotiation of warehouse receipts was a symbolic delivery of the commodities represented by the receipts and passes title thereto. Venus Foods v. District Court, 67 Idaho 390, 181 P.2d 775 (1947).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 60 et seq.

67A Am. Jur. 2d, Sales, § 953 et seq.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-502.

Changes: To accommodate electronic documents of title and for style.

Purposes:

1. This section applies to both tangible and electronic documents of title. The elements of duly negotiated, which constitutes a due negotiation, are set forth in Section 7-501. The several necessary qualifications of the broad principle that the holder of a document acquired in a due negotiation is the

owner of the document and the goods have been brought together in the next section (Section 7-503).

2. Subsection (a)(3) covers the case of "feeding" of a duly negotiated document by subsequent delivery to the bailee of such goods as the document falsely purported to cover; the bailee in such case is estopped as against the holder of the document.

3. The explicit statement in subsection (a)(4) of the bailee's direct obligation to the holder precludes the defense that the document in question was "spent" after the carrier had delivered the goods to a previous holder. But the holder is subject to such defenses as nonnegligent destruction even though not apparent on the document. The sentence on delivery orders applies only to delivery orders in negotiable form which have been duly negotiated. On delivery orders, see also Section 7-503(b) and Comment.

4. Subsection (b) continues the law which gave full effect to the issuance or due negotiation of a negotiable document. The subsection adds nothing to the effect of the rules stated in subsection (a), but it has been included since such explicit reference was provided under former Section 7-502 to preserve the right of a purchaser by due negotiation. The listing is not exhaustive. The language "any stoppage" is included lest an inference be drawn that a stoppage of the goods before or after transit might cut off or otherwise impair the purchaser's rights.

Cross References: Sections 7-103, 7-205, 7-403, 7-501, and 7-503.

Definitional Cross References: "Bailee". Section 7-102.

"Control". Section 7-106.

"Delivery". Section 1-201.

"Delivery order". Section 7-102.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Fungible". Section 1-201.

"Goods". Section 7-102.

"Holder". Section 1-201.

"Issuer". Section 7-102.

"Person". Section 1-201.

"Rights". Section 1-201.

"Term". Section 1-201.

"Warehouse receipt". Section 1-201.

§ 28-7-503. Document of title to goods defeated in certain cases. — (a) A document of title confers no right in goods against a person that before issuance of the document had a legal interest or a perfected security interest in the goods and that did not:

(1) Deliver or entrust the goods or any document of title covering the goods to the bailor or the bailor's nominee with: (A) Actual or apparent authority to ship, store, or sell; (B) Power to obtain delivery under section 28-7-403[, Idaho Code]; or (C) Power of disposition under section 28-2-403, 28-12-304(2), 28-12-305(2), 28-9-320 or 28-9-321(c)[, Idaho Code], or other statute or rule of law; or (2) Acquiesce in the procurement by the bailor or its nominee of any document.

(b) Title to goods based upon an unaccepted delivery order is subject to the rights of any person to which a negotiable warehouse receipt or bill of lading covering the goods has been duly negotiated. That title may be defeated under section 28-7-504[, Idaho Code,] to the same extent as the rights of the issuer or a transferee from the issuer.

(c) Title to goods based upon a bill of lading issued to a freight forwarder is subject to the rights of any person to which a bill issued by the freight forwarder is duly negotiated. However, delivery by the carrier in accordance with part 4 of this chapter pursuant to its own bill of lading discharges the carrier's obligation to deliver.

History.

I.C., § 28-7-503, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-503, which comprised 1967, ch. 161, § 7-503, p. 351; am. 2001, ch. 208, § 13, p. 704, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertions in paragraphs (a)(1)(B) and (a)(1)(C) and subsection (b) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Decisions Under Prior Law

Symbolic Delivery.

The negotiation of warehouse receipts was a symbolic delivery of the commodities represented by the receipts and passed title thereto. Venus Foods v. District Court, 67 Idaho 390, 181 P.2d 775 (1947).

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 62.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-503.

Changes: Changes to cross-reference to Article 2A and for style.

Purposes:

1. In general it may be said that the title of a purchaser by due negotiation prevails over almost any interest in the goods which existed prior to the procurement of the document of title if the possession of the goods by the person obtaining the document derived from any action by the prior claimant which introduced the goods into the stream of commerce or carried them along that stream. A thief of the goods cannot indeed by shipping or storing them to the thief's own order acquire power to transfer them to a good faith purchaser. Nor can a tenant or mortgagor defeat any rights of a landlord or mortgagee which have been perfected under the local law merely by wrongfully shipping or storing a portion of the crop or other goods. However, "acquiescence" by the landlord or mortgagee does not require active consent under subsection (a)(2) and knowledge of the likelihood of storage or shipment with no objection or effort to control it is sufficient to defeat the landlord's or the mortgagee's rights as against one who takes by due negotiation of a negotiable document. *In re Sharon Steel*,

176 B.R. 384 (Bankr. W.D. Pa. 1995); *In re R.V. Segars Co*., 54 B.R. 170 (Bankr. S.C. 1985); *In re Jamestown Elevators, Inc*., 49 B.R. 661 (Bankr. N.D. 1985).

On the other hand, where goods are delivered to a factor for sale, even though the factor has made no advances and is limited in its duty to sell for cash, the goods are "entrusted" to the factor "with actual . . . authority . . . to sell" under subsection (a)(1), and if the factor procures a negotiable document of title it can transfer the owner's interest to a purchaser by due negotiation. Further, where the factor is in the business of selling, goods entrusted to it simply for safekeeping or storage may be entrusted under circumstances which give the factor "apparent authority to ship, store or sell" under subsection (a)(1), or power of disposition under Section 2-403, 2A-304(2), 2A-305(2), 7-205, 9-320, or 9-321(c) or under a statute such as the earlier Factors Acts, or under a rule of law giving effect to apparent ownership. See Section 1-103.

Persons having an interest in goods also frequently deliver or entrust them to agents or servants other than factors for the purpose of shipping or warehousing or under circumstances reasonably contemplating such action. This Act is clear that such persons assume full risk that the agent to whom the goods are so delivered may ship or store in breach of duty, take a document to the agent's own order and then proceed to misappropriate the negotiable document of title that embodies the goods. This Act makes no distinction between possession or mere custody in such situations and finds no exception in the case of larceny by a bailee or the like. The safeguard in such situations lies in the requirement that a due negotiation can occur only "in the regular course of business or financing" and that the purchase be in good faith and without notice. See Section 7-501. Documents of title have no market among the commercially inexperienced and the commercially experienced do not take them without inquiry from persons known to be truck drivers or petty clerks even though such persons purport to be operating in their own names.

Again, where the seller allows a buyer to receive goods under a contract for sale, though as a "conditional delivery" or under "cash sale" terms and on explicit agreement for immediate payment, the buyer thereby acquires power to defeat the seller's interest by transfer of the goods to certain good faith purchasers. See Section 2-403. Both in policy and under the language

of subsection (a)(1) that same power must be extended to accomplish the same result if the buyer procures a negotiable document of title to the goods and duly negotiates it.

This Comment 1 should be considered in interpreting delivery, entrustment or acquiescence in application of Section 7-209(c).

2. Under subsection (a) a delivery order issued by a person having no right in or power over the goods is ineffective unless the owner acts as provided in subsection (a)(1) or (2). Thus the rights of a transferee of a non-negotiable warehouse receipt can be defeated by a delivery order subsequently issued by the transferor only if the transferee "delivers or entrusts" to the "person procuring" the delivery order or "acquiesces" in that person's procurement. Similarly, a second delivery order issued by the same issuer for the same goods will ordinarily be subject to the first, both under this section and under Section 7-402. After a delivery order is validly issued but before it is accepted, it may nevertheless be defeated under subsection (b) in much the same way that the rights of a transferee may be defeated under Section 7-504. For example, a buyer in ordinary course from the issuer may defeat the rights of the holder of a prior delivery order if the bailee receives notification of the buyer's rights before notification of the holder's rights. Section 7-504(b)(2). But an accepted delivery order has the same effect as a document issued by the bailee.

3. Under subsection (c) a bill of lading issued to a freight forwarder is subordinated to the freight forwarder's document of title, since the bill on its face gives notice of the fact that a freight forwarder is in the picture and the freight forwarder has in all probability issued a document of title. But the carrier is protected in following the terms of its own bill of lading.

Cross References: Point 1: Sections 1-103, 2-403, 2A-304(2), 2A-305(2), 7-205, 7-209, 7-501, 9-320, 9-321(c), and 9-331.

Point 2: Sections 7-402 and 7-504.

Point 3: Sections 7-402, 7-403, and 7-404.

Definitional Cross References: "Bill of lading". Section 1-201.

"Contract for sale". Section 2-106.

"Delivery". Section 1-201.

"Delivery order". Section 7-102.

"Document of title". Section 1-201.

"Duly negotiate". Section 7-501.

"Goods". Section 7-102.

"Person". Section 1-201.

"Right". Section 1-201.

"Warehouse receipt". Section 1-201.

§ 28-7-504. Rights acquired in absence of due negotiation — Effect of diversion — Stoppage of delivery. — (a) A transferee of a document of title, whether negotiable or nonnegotiable, to which the document has been delivered but not duly negotiated, acquires the title and rights that its transferor had or had actual authority to convey.

(b) In the case of a transfer of a nonnegotiable document of title, until but not after the bailee receives notice of the transfer, the rights of the transferee may be defeated: (1) By those creditors of the transferor which could treat the transfer as void under section 28-2-402 or 28-12-308[, Idaho Code]; (2) By a buyer from the transferor in ordinary course of business if the bailee has delivered the goods to the buyer or received notification of the buyer's rights; (3) By a lessee from the transferor in ordinary course of business if the bailee has delivered the goods to the lessee or received notification of the lessee's rights; or (4) As against the bailee, by good-faith dealings of the bailee with the transferor.

(c) A diversion or other change of shipping instructions by the consignor in a nonnegotiable bill of lading which causes the bailee not to deliver the goods to the consignee defeats the consignee's title to the goods if the goods have been delivered to a buyer in ordinary course of business or a lessee in ordinary course of business and, in any event, defeats the consignee's rights against the bailee.

(d) Delivery of the goods pursuant to a nonnegotiable document of title may be stopped by a seller under section 28-2-705[, Idaho Code,] or a lessor under section 28-12-526[, Idaho Code], subject to the requirements of due notification in those sections. A bailee that honors the seller's or lessor's instructions is entitled to be indemnified by the seller or lessor against any resulting loss or expense.

History.

I.C., § 28-7-504, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-504, which comprised 1967, ch. 161, § 7-504, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertions in paragraphs (b)(1) and subsection (d) were added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, §§ 63, 64.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-504.

Changes: To include cross-references to Article 2A and for style.

Purposes:

1. Under the general principles controlling negotiable documents, it is clear that in the absence of due negotiation a transferor cannot convey greater rights than the transferor has, even when the negotiation is formally perfect. This section recognizes the transferor's power to transfer rights which the transferor has or has "actual authority to convey." Thus, where a negotiable document of title is being transferred the operation of the principle of estoppel is not recognized, as contrasted with situations involving the transfer of the goods themselves. (Compare Section 2-403 on good faith purchase of goods.) This section applies to both tangible and electronic documents of title.

A necessary part of the price for the protection of regular dealings with negotiable documents of title is an insistence that no dealing which is in any way irregular shall be recognized as a good faith purchase of the document or of any rights pertaining to it. So, where the transfer of a negotiable document fails as a negotiation because a requisite indorsement is forged or otherwise missing, the purchaser in good faith and for value may be in the anomalous position of having less rights, in part, than if the purchaser had purchased the goods themselves. True, the purchaser's rights are not subject to defeat by attachment of the goods or surrender of them to the purchaser's transferor (contrast subsection (b)); but on the other hand, the purchaser

cannot acquire enforceable rights to control or receive the goods over the bailee's objection merely by giving notice to the bailee. Similarly, a consignee who makes payment to its consignor against a straight bill of lading can thereby acquire the position of a good faith purchaser of goods under provisions of the Article of this Act on Sales (Section 2-403), whereas the same payment made in good faith against an unendorsed order bill would not have such effect. The appropriate remedy of a purchaser in such a situation is to regularize its status by compelling indorsement of the document (see Section 7-506).

2. As in the case of transfer—as opposed to "due negotiation"—of negotiable documents, subsection (a) empowers the transferor of a nonnegotiable document to transfer only such rights as the transferor has or has "actual authority" to convey. In contrast to situations involving the goods themselves the operation of estoppel or agency principles is not here recognized to enable the transferor to convey greater rights than the transferor actually has. Subsection (b) makes it clear, however, that the transferee of a nonnegotiable document may acquire rights greater in some respects than those of his transferor by giving notice of the transfer to the bailee. New subsection (b)(3) provides for the rights of a lessee in the ordinary course.

Subsection (b)(2) and (3) require delivery of the goods. Delivery of the goods means the voluntary transfer of physical possession of the goods. See amended Section 2-103.

3. Subsection (c) is in part a reiteration of the carrier's immunity from liability if it honors instructions of the consignor to divert, but there is added a provision protecting the title of the substituted consignee if the latter is a buyer in ordinary course of business. A typical situation would be where a manufacturer, having shipped a lot of standardized goods to A on nonnegotiable bill of lading, diverts the goods to customer B who pays for them. Under pre-Code passage-of-title-by-appropriation doctrine A might reclaim the goods from B. However, no consideration of commercial policy supports this involvement of an innocent third party in the default of the manufacturer on his contract to A; and the common commercial practice of diverting goods in transit suggests a trade understanding in accordance with this subsection. The same result should obtain if the substituted consignee is a lessee in ordinary course. The extent of the lessee's interest in the goods is

less than a buyer's interest in the goods. However, as against the first consignee and the lessee in ordinary course as the substituted consignee, the lessee's rights in the goods as granted under the lease are superior to the first consignee's rights.

4. Subsection (d) gives the carrier an express right to indemnity where the carrier honors a seller's request to stop delivery.

5. Section 1-202 gives the bailee protection, if due diligence is exercised where the bailee's organization has not had time to act on a notification.

Cross References: Point 1: Sections 2-403 and 7-506.

Point 2: Sections 2-403 and 2A-304.

Point 3: Sections 7-303, 7-403(a)(5), and 7-404.

Point 4: Sections 2-705 and 7-403(a)(4).

Point 5: Section 1-202.

Definitional Cross References: "Bailee". Section 7-102.

"Bill of lading". Section 1-201.

"Buyer in ordinary course of business". Section 1-201.

"Consignee". Section 7-102.

"Consignor". Section 7-102.

"Creditor". Section 1-201.

"Delivery". Section 1-201.

"Document of Title". Section 1-201.

"Duly negotiate". Section 7-501.

"Good faith". Section 1-201 [7-102].

"Goods". Section 7-102.

"Honor". Section 1-201.

"Lessee in ordinary course". Section 2A-103.

"Notification". Section 1-202.

"Purchaser". Section 1-201.

“Rights”. Section 1-201.

§ 28-7-505. Indorser not guarantor for other parties. — The indorsement of a tangible document of title issued by a bailee does not make the indorser liable for any default by the bailee or previous indorsers.

History.

I.C., § 28-7-505, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-505, which comprised 1967, ch. 161, § 7-505, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 65.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-505.

Changes: Limited to tangible documents of title.

Purposes: This section is limited to tangible documents of title as the concept of indorsement is irrelevant to electronic documents of title. Electronic documents of title will be transferred by delivery of control. Section 7-106. The indorsement of a tangible document of title is generally understood to be directed towards perfecting the transferee's rights rather than towards assuming additional obligations. The language of the present section, however, does not preclude the one case in which an indorsement given for value guarantees future action, namely, that in which the bailee has not yet become liable upon the document at the time of the indorsement. Under such circumstances the indorser, of course, engages that appropriate honor of the document by the bailee will occur. See Section 7-502(a)(4) as to negotiable delivery orders. However, even in such a case,

once the bailee attorns to the transferee, the indorser's obligation has been fulfilled and the policy of this section excludes any continuing obligation on the part of the indorser for the bailee's ultimate actual performance.

Cross References: Sections 7-106 and 7-502.

Definitional Cross References: "Bailee". Section 7-102.

"Document of title". Section 1-201.

"Party". Section 1-201.

§ 28-7-506. Delivery without indorsement — Right to compel indorsement. — The transferee of a negotiable tangible document of title has a specifically enforceable right to have its transferor supply any necessary indorsement, but the transfer becomes a negotiation only as of the time the indorsement is supplied.

History.

I.C., § 28-7-506, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-506, which comprised 1967, ch. 161, § 7-506, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 56.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-506.

Changes: Limited to tangible documents of title.

Purposes: 1. This section is limited to tangible documents of title as the concept of indorsement is irrelevant to electronic documents of title. Electronic documents of title will be transferred by delivery of control. Section 7-106. From a commercial point of view the intention to transfer a tangible negotiable document of title which requires an indorsement for its transfer, is incompatible with an intention to withhold such indorsement and so defeat the effective use of the document. Further, the preceding section and the Comment thereto make it clear that an indorsement generally imposes no responsibility on the indorser.

2. Although this section provides that delivery of a tangible document of title without the necessary indorsement is effective as a transfer, the

transferee, of course, has not regularized its position until such indorsement is supplied. Until this is done the transferee cannot claim rights under due negotiation within the requirements of this Article (Section 7-501(a)(5)) on "due negotiation." Similarly, despite the transfer to the transferee of the transferor's title, the transferee cannot demand the goods from the bailee until the negotiation has been completed and the document is in proper form for surrender. See Section 7-403(c).

Cross References: Point 1: Sections 7-106 and 7-505.

Point 2: Sections 7-501(a)(5) and 7-403(c).

Definitional Cross References: "Document of title". Section 1-201.

"Rights". Section 1-201.

§ 28-7-507. Warranties on negotiation or delivery of document of title.

— If a person negotiates or delivers a document of title for value, otherwise than as a mere intermediary under section 28-7-508[, Idaho Code], unless otherwise agreed, the transferor, in addition to any warranty made in selling or leasing the goods, warrants to its immediate purchaser only that:

(1) The document is genuine; (2) The transferor does not have knowledge of any fact that would impair the document's validity or worth; and (3) The negotiation or delivery is rightful and fully effective with respect to the title to the document and the goods it represents.

History.

I.C., § 28-7-507, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-507, which comprised 1967, ch. 161, § 7-507, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Compiler's Notes.

The bracketed insertion in the introductory paragraph was added by the compiler to conform to the statutory citation style.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 66.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-507.

Changes: Substitution of the word "delivery" for the word "transfer," reference leasing transactions and style.

Purposes: 1. Delivery of goods by use of a document of title does not limit or displace the ordinary obligations of a seller or lessor as to any warranties regarding the goods that arises under other law. If the transfer of documents attends or follows the making of a contract for the sale or lease of goods, the general obligations on warranties as to the goods (Sections 2-312 through 2-318 and Sections 2A-210 through 2A-316) are brought to bear as well as the special warranties under this section.

2. The limited warranties of a delivering or collecting intermediary, including a collecting bank, are stated in Section 7-508.

Cross References: Point 1: Sections 2-312 through 2-318 and 2A-310 through 2A-316.

Point 2: Section 7-508.

Definitional Cross References: "Delivery". Section 1-201.

"Document of title". Section 1-201.

"Genuine". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Purchaser". Section 1-201.

"Value". Section 1-204.

§ 28-7-508. Warranties of collecting bank as to documents of title. — A collecting bank or other intermediary known to be entrusted with documents of title on behalf of another or with collection of a draft or other claim against delivery of documents warrants by the delivery of the documents only its own good faith and authority even if the collecting bank or other intermediary has purchased or made advances against the claim or draft to be collected.

History.

I.C., § 28-7-508, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-508, which comprised 1967, ch. 161, § 7-508, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 67.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-508.

Changes: Changes for style only.

Purposes:

1. To state the limited warranties given with respect to the documents accompanying a documentary draft.

2. In warranting its authority a collecting bank or other intermediary only warrants its authority from its transferor. See Section 4-203. It does not warrant the genuineness or effectiveness of the document. Compare Section 7-507.

3. Other duties and rights of banks handling documentary drafts for collection are stated in Article 4, Part 5. On the meaning of draft, see Section 4-104 and Section 5-102, Comment 11.

Cross References: Sections 4-104, 4-203, 4-501 through 4-504, 5-102, and 7-507.

Definitional Cross References: "Collecting bank". Section 4-105.

"Delivery". Section 1-201.

"Document of title". Section 1-102.

"Documentary draft". Section 4-104.

"Intermediary bank". Section 4-105.

"Good faith". Section 1-201 [7-102].

§ 28-7-509. Adequate compliance with commercial contract. — Whether a document of title is adequate to fulfill the obligations of a contract for sale, a contract for lease, or the conditions of a letter of credit is determined by chapter 2, 5 or 12, title 28, Idaho Code.

History.

I.C., § 28-7-509, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-509, which comprised 1967, ch. 161, § 7-509, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-509.

Changes: To reference Article 2A.

Purposes: To cross-refer to the Articles of this Act which deal with the substantive issues of the type of document of title required under the contract entered into by the parties.

Cross References: Articles 2, 2A and 5.

Definitional Cross References: “Contract for sale”. Section 2-106.

“Document of title”. Section 1-201.

“Lease”. Section 2A-103.

Part 6
Warehouse Receipts and Bills of Lading — Miscellaneous Provisions

§ 28-7-601. Lost, stolen, or destroyed documents of title. — (a) If a document of title is lost, stolen, or destroyed, a court may order delivery of the goods or issuance of a substitute document and the bailee may without liability to any person comply with the order. If the document was negotiable, a court may not order delivery of the goods or issuance of a substitute document without the claimant's posting security unless it finds that any person that may suffer loss as a result of nonsurrender of possession or control of the document is adequately protected against the loss. If the document was nonnegotiable, the court may require security. The court may also order payment of the bailee's reasonable costs and attorney's fees in any action under this subsection.

(b) A bailee that, without a court order, delivers goods to a person claiming under a missing negotiable document of title is liable to any person injured thereby. If the delivery is not in good faith, the bailee is liable for conversion. Delivery in good faith is not conversion if the claimant posts security with the bailee in an amount at least double the value of the goods at the time of posting to indemnify any person injured by the delivery which files a notice of claim within one (1) year after the delivery.

History.

I.C., § 28-7-601, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-601, which comprised 1967, ch. 161, § 7-601, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 15A Am. Jur. 2d, Commercial Code, § 38.

Official Comment

Prior Uniform Statutory Provision: Former Section 7-601.

Changes: To accommodate electronic documents; to provide flexibility to courts similar to the flexibility in Section 3-309; to update to the modern era of deregulation; and for style.

Purposes:

1. Subsection (a) authorizes courts to order compulsory delivery of the goods or compulsory issuance of a substitute document. Compare Section 7-402. Using language similar to that found in Section 3-309, courts are given discretion as to what is adequate protection when the lost, stolen or destroyed document was negotiable or whether security should be required when the lost, stolen or destroyed document was nonnegotiable. In determining whether a party is adequately protected against loss in the case of a negotiable document, the court should consider the likelihood that the party will suffer a loss. The court is also given discretion as to the bailee's costs and attorney fees. The rights and obligations of a bailee under this section depend upon whether the document of title is lost, stolen or destroyed and is in addition to the ability of the bailee to bring an action for interpleader. See Section 7-603.

2. Courts have the authority under this section to order a substitute document for either tangible or electronic documents. If the substitute document will be in a different medium than the original document, the court should fashion its order in light of the requirements of Section 7-105.

3. Subsection (b) follows prior Section 7-601 in recognizing the legality of the well established commercial practice of bailees making delivery in good faith when they are satisfied that the claimant is the person entitled under a missing (i.e., lost, stolen, or destroyed) negotiable document. Acting without a court order, the bailee remains liable on the original negotiable document and, to avoid conversion liability, the bailee may insist that the claimant provide an indemnity bond. Cf. Section 7-403.

4. Claimants on nonnegotiable instruments are permitted to avail themselves of the subsection (a) procedure because straight (nonnegotiable) bills of lading sometimes contain provisions that the goods shall not be delivered except upon production of the bill. If the carrier should choose to insist upon production of the bill, the consignee should have some means of compelling delivery on satisfactory proof of entitlement. Without a court order, a bailee may deliver, subject to Section 7-403, to a person claiming goods under a nonnegotiable document that the same person claims is lost, stolen, or destroyed.

5. The bailee's lien should be protected when a court orders delivery of the goods pursuant to this section.

Cross References: Point 1: Sections 3-309, 7-402 and 7-603.

Point 2: Section 7-105.

Point 3: Section 7-403.

Point 4: Section 7-403.

Point 5: Sections 7-209 and 7-307.

Definitional Cross References: "Bailee". Section 7-102.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Good faith". Section 1-201 [7-102].

"Goods". Section 7-102.

"Person". Section 1-201.

§ 28-7-602. Judicial process against goods covered by negotiable documents of title. — Unless a document of title was originally issued upon delivery of the goods by a person that did not have power to dispose of them, a lien does not attach by virtue of any judicial process to goods in the possession of a bailee for which a negotiable document of title is outstanding unless possession or control of the document is first surrendered to the bailee or the document's negotiation is enjoined. The bailee may not be compelled to deliver the goods pursuant to process until possession or control of the document is surrendered to the bailee or to the court. A purchaser of the document for value without notice of the process or injunction takes free of the lien imposed by judicial process.

History.

I.C., § 28-7-602, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-602, which comprised 1967, ch. 161, § 7-602, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

RESEARCH REFERENCES

Am. Jur. 2d. — 68A Am. Jur. 2d, Secured Transactions, § 529 et seq.

Official Comment

Prior Uniform Statutory Provisions: Former Section 7-602.

Changes: Changes to accommodate electronic documents of title and for style.

Purposes: 1. The purpose of the section is to protect the bailee from conflicting claims of the document of title holder and the judgment creditors of the person who deposited the goods. The rights of the former prevail

unless, in effect, the judgment creditors immobilize the negotiable document of title through the surrender of possession of a tangible document or control of an electronic document. However, if the document of title was issued upon deposit of the goods by a person who had no power to dispose of the goods so that the document is ineffective to pass title, judgment liens are valid to the extent of the debtor's interest in the goods.

2. The last sentence covers the possibility that the holder of a document who has been enjoined from negotiating it will violate the injunction by negotiating to an innocent purchaser for value. In such case the lien will be defeated.

Cross References: Sections 7-106 and 7-501 through 7-503.

Definitional Cross References: "Bailee". Section 7-102.

"Delivery". Section 1-201.

"Document of title". Section 1-201.

"Goods". Section 7-102.

"Notice". Section 1-202.

"Person". Section 1-201.

"Purchase". Section 1-201.

"Value". Section 1-204.

§ 28-7-603. Conflicting claims — Interpleader. — If more than one (1) person claims title to or possession of the goods, the bailee is excused from delivery until the bailee has a reasonable time to ascertain the validity of the adverse claims or to commence an action for interpleader. The bailee may assert an interpleader either in defending an action for nondelivery of the goods or by original action.

History.

I.C., § 28-7-603, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-7-603, which comprised 1967, ch. 161, § 7-603, p. 351, was repealed by S.L. 2004, ch. 42, § 1.

Official Comment

Prior Uniform Statutory Provisions: Former Section 7-603.

Changes: Changes for style only.

Purposes: 1. The section enables a bailee faced with conflicting claims to the goods to compel the claimants to litigate their claims with each other rather than with the bailee. The bailee is protected from legal liability when the bailee complies with court orders from the interpleader. *See e.g., Northwestern National Sales, Inc. v. Commercial Cold Storage, Inc.*, 162 Ga. App. 741, 293 S.E.2d 30 (1982).

2. This section allows the bailee to bring an interpleader action but does not provide an exclusive basis for allowing interpleader. If either state or federal procedural rules allow an interpleader in other situations, the bailee may commence an interpleader under those rules. Even in an interpleader to which this section applies, the state or federal process of interpleader applies to the bailee's action for interpleader. For example, state or federal interpleader statutes or rules may permit a bailee to protect its lien or to seek attorney's fees and costs in the interpleader action.

Cross Reference: Point 1: Section 7-403.

Definitional Cross References: "Action". Section 1-201.

"Bailee". Section 7-102.

"Delivery". Section 1-201.

"Goods". Section 7-102.

"Person". Section 1-201.

"Reasonable time". Section 1-205.

Part 7
Miscellaneous Provisions

§ 28-7-701. Effective date. — This act takes effect on July 1, 2004.

History.

I.C., § 28-7-701, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Compiler's Notes.

The term "this act" refers to S.L. 2004, ch. 42, which revised Article (Chapter) 7 of the Uniform Commercial Code and amended many other sections of the Idaho Code in conformity with that revision.

§ 28-7-702. Repeals. — Existing chapter 7, title 28, Idaho Code, and section 28-10-104, Idaho Code, are repealed.

History.

I.C., § 28-7-702, as added by 2004, ch. 42, § 2, p. 77.

Official Comment

A state should repeal its prior version of Uniform Commercial Code Article 7 on documents of title and Uniform Commercial Code section 10-204. The substance of Section 10-104 has been incorporated into Section 7-103(b).

§ 28-7-703. Applicability. — This act applies to a document of title that is issued or a bailment that arises on or after July 1, 2004. This act does not apply to a document of title that is issued or a bailment that arises before July 1, 2004, even if the document of title or bailment would be subject to this act if the document of title had been issued or bailment had arisen on or after July 1, 2004. This act does not apply to a right of action that has accrued before July 1, 2004.

History.

I.C., § 28-7-703, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Compiler's Notes.

The term "this act" refers to S.L. 2004, ch. 42, which revised Article (Chapter) 7 of the Uniform Commercial Code and amended many other sections of the Idaho Code in conformity with that revision.

Official Comment This Act will apply prospectively only to documents of title issued or bailments that arise after the effective date of the Act.

§ 28-7-704. Savings clause. — A document of title issued or a bailment that arises before July 1, 2004, and the rights, obligations, and interests flowing from that document or bailment are governed by any statute or other rule amended or repealed by this act as if amendment or repeal had not occurred and may be terminated, completed, consummated, or enforced under that statute or other rule.

History.

I.C., § 28-7-704, as added by 2004, ch. 42, § 2, p. 77.

STATUTORY NOTES

Compiler's Notes.

The term "this act" refers to S.L. 2004, ch. 42, which revised Article (Chapter) 7 of the Uniform Commercial Code and amended many other sections of the Idaho Code in conformity with that revision.

Official Comment This Act will apply prospectively only to documents of title issued or bailments that arise after the effective date of the Act. To the extent that issues arise based upon documents of title or rights or obligations that arise prior to the effective date of this Act, prior law will apply to resolve those issues.

Chapter 8
INVESTMENT SECURITIES

Part 1. Short Title and General Matters

Sec.

Part 2. Issue and Issuer

Part 3. Transfer of Certificated and Uncertificated Securities

Part 4. Registration

Part 1
Short Title and General Matters

Idaho Code § 28-8-101

§ 28-8-101. Short title. — This chapter may be cited as "Uniform Commercial Code — Investment Securities."

History.

I.C., § 28-8-101, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

The following former sections were repealed by S.L. 1995, ch. 272, § 1, effective July 1, 1995: § 28-8-101, which comprised 1967, ch. 161, § 8-101, p. 351.

§ 28-8-102, which comprised I.C., § 28-8-102, as added by 1985, ch. 135, § 2, p. 329.

§ 28-8-103, which comprised 1967, ch. 161, § 8-103, p. 351; am. 1985, ch. 135, § 3, p. 329.

§ 28-8-104, which comprised 1967, ch. 161, § 8-104, p. 351; am. 1985, ch. 135, § 4, p. 329.

§ 28-8-105, which comprised I.C., § 28-8-105, as added by 1985, ch. 135, § 5, p. 329.

§ 28-8-106, which comprised 1967, ch. 161, § 8-106, p. 351; am. 1985, ch. 135, § 6, p. 329.

§ 28-8-107, which comprised 1967, ch. 161, § 8-107, p. 351; am. 1985, ch. 135, § 7, p. 329.

§ 28-8-108, which comprised I.C., § 28-8-108, as added by 1985, ch. 135, § 8, p. 329.

§ 28-8-201, which comprised 1967, ch. 161, § 8-201, p. 351; am. 1985, ch. 135, § 9, p. 329.

§ 28-8-202, which comprised 1967, ch. 161, § 8-202, p. 351; am. 1985, ch. 135, § 10, p. 329.

§ 28-8-203, which comprised 1967, ch. 161, § 8-203, p. 351; am. 1985, ch. 135, § 11, p. 329.

§ 28-8-204, which comprised I.C., § 28-8-204, as added by 1985, ch. 135, § 12, p. 329.

§ 28-8-205, which comprised 1967, ch. 161, § 8-205, p. 351; am. 1985, ch. 135, § 13, p. 329.

§ 28-8-206, which comprised 1967, ch. 161, § 8-206, p. 351; am. 1985, ch. 135, § 14, p. 329.

§ 28-8-207, which comprised 1967, ch. 161, § 8-207, p. 351; am. 1985, ch. 135, § 15, p. 329.

§ 28-8-208, which comprised 1967, ch. 161, § 8-208, p. 351; am. 1985, ch. 135, § 16, p. 329.

§ 28-8-301, which comprised I.C., § 28-8-301, as added by 1985, ch. 135, § 17, p. 329.

§ 28-8-302, which comprised 1967, ch. 161, § 8-302, p. 351; am. 1985, ch. 135, § 18, p. 329.

§ 28-8-303, which comprised 1967, ch. 161, § 8-303, p. 351.

§ 28-8-304, which comprised 1967, ch. 161, § 8-304, p. 351; am. 1985, ch. 135, § 19, p. 329.

§ 28-8-305, which comprised 1967, ch. 161, § 8-305, p. 351; am. 1985, ch. 135, § 20, p. 329.

§ 28-8-306, which comprised 1967, ch. 161, § 8-306, p. 351; am. 1985, ch. 135, § 21, p. 329.

§ 28-8-307, which comprised 1967, ch. 161, § 8-307, p. 351; am. 1985, ch. 135, § 22, p. 329.

§ 28-8-308, which comprised I.C., § 28-8-308, as added by 1985, ch. 135, § 23, p. 329.

§ 28-8-309, which comprised 1967, ch. 161, § 8-309, p. 351; am. 1985, ch. 135, § 24, p. 329.

§ 28-8-310, which comprised 1967, ch. 161, § 8-310, p. 351; am. 1985, ch. 135, § 25, p. 329.

§ 28-8-311, which comprised 1967, ch. 161, § 8-311, p. 351; am. 1985, ch. 135, § 26, p. 329.

§ 28-8-312, which comprised I.C., § 28-8-312, as added by 1985, ch. 135, § 27, p. 329.

§ 28-8-313, which comprised I.C., § 28-8-313, as added by 1985, ch. 135, § 28, p. 329.

§ 28-8-314, which comprised 1967, ch. 161, § 8-314, p. 351; am. 1985, ch. 135, § 29, p. 329.

§ 28-8-315, which comprised 1967, ch. 161, § 8-315, p. 351; am. 1985, ch. 135, § 30, p. 329.

§ 28-8-316, which comprised 1967, ch. 161, § 8-316, p. 351; am. 1985, ch. 135, § 31, p. 329.

§ 28-8-317, which comprised 1967, ch. 161, § 8-317, p. 351; am. 1985, ch. 135, § 32, p. 329.

§ 28-8-318, which comprised 1967, ch. 161, § 8-318, p. 351; am. 1985, ch. 135, § 33, p. 329.

§ 28-8-319, which comprised 1967, ch. 161, § 8-319, p. 351; am. 1985, ch. 135, § 34, p. 329.

§ 28-8-320, which comprised I.C., § 28-8-320, as added by 1985, ch. 135, § 35, p. 329.

§ 28-8-321, which comprised I.C., § 28-8-321, as added by 1985, ch. 135, § 36, p. 329.

§ 28-8-401, which comprised 1967, ch. 161, § 8-401, p. 351; am. 1985, ch. 135, § 37, p. 329.

§ 28-8-402, which comprised 1967, ch. 161, § 8-402, p. 351; am. 1985, ch. 135, § 38, p. 329.

§ 28-8-403, which comprised 1967, ch. 161, § 8-403, p. 351; am. 1985, ch. 135, § 39, p. 329.

§ 28-8-404, which comprised 1967, ch. 161, § 8-404, p. 351; am. 1985, ch. 135, § 40, p. 329.

§ 28-8-405, which comprised 1967, ch. 161, § 8-405, p. 351; am. 1985, ch. 135, § 41, p. 329.

§ 28-8-406, which comprised 1967, ch. 161, § 8-406, p. 351; am. 1985, ch. 135, § 42, p. 329.

§ 28-8-407, which comprised I.C., § 28-8-407, as added by 1985, ch. 135, § 43, p. 329.

§ 28-8-408, which comprised I.C., § 28-8-408, as added by 1985, ch. 135, § 44, p. 329.

Compiler's Notes.

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The Idaho Legislature in adopting the Uniform Commercial Code — Investment Securities did not adopt §§ 8-601 and 8-602 of the official version. Section 8-603 of the official version was adopted as § 28-8-117.

RESEARCH REFERENCES

ALR. — Construction and effect of UCC Art. 8, dealing with investment securities. 21 A.L.R.3d 964; 88 A.L.R.3d 949.

Who is "bona fide purchaser" of investment security under UCC § 8-302. 88 A.L.R.3d 949.

Effect of asset freeze obtained by Securities and Exchange Commission on attorney's fees paid or owed by company subject to freeze. 161 A.L.R. Fed. 233.

§ 28-8-102. Definitions. — (1) In this chapter:

(a) "Adverse claim" means a claim that a claimant has a property interest in a financial asset and that it is a violation of the rights of the claimant for another person to hold, transfer or deal with the financial asset.

(b) "Bearer form," as applied to a certificated security, means a form in which the security is payable to the bearer of the security certificate according to its terms but not by reason of an indorsement.

(c) "Broker" means a person defined as a broker or dealer under the federal securities laws, but without excluding a bank acting in that capacity.

(d) "Certificated security" means a security that is represented by a certificate.

(e) "Clearing corporation" means:

(i) A person that is registered as a "clearing agency" under the federal securities laws;

(ii) A federal reserve bank; or

(iii) Any other person that provides clearance or settlement services with respect to financial assets that would require it to register as a clearing agency under the federal securities laws but for an exclusion or exemption from the registration requirement, if its activities as a clearing corporation, including promulgation of rules, are subject to regulation by a federal or state governmental authority.

(f) "Communicate" means to:

(i) Send a signed writing; or

(ii) Transmit information by any mechanism agreed upon by the persons transmitting and receiving the information.

(g) "Entitlement holder" means a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. If a person acquires a security entitlement by

virtue of section 28-8-501(2)(b) or (2)(c)[, Idaho Code], that person is the entitlement holder.

(h) “Entitlement order” means a notification communicated to a securities intermediary directing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement.

(i) “Financial asset,” except as otherwise provided in section 28-8-103[, Idaho Code], means:

(i) A security;

(ii) An obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognized in any area in which it is issued or dealt in as a medium for investment; or

(iii) Any property that is held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this chapter.

As context requires, the term means either the interest itself or the means by which a person’s claim to it is evidenced, including a certificated or uncertificated security, a security certificate or a security entitlement.

(j) “Good faith,” for purposes of the obligation of good faith in the performance or enforcement of contracts or duties within this chapter, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(k) “Indorsement” means a signature that alone or accompanied by other words is made on a security certificate in registered form or on a separate document for the purpose of assigning, transferring or redeeming the security or granting a power to assign, transfer, or redeem it.

(*l*) “Instruction” means a notification communicated to the issuer of an uncertificated security which directs that the transfer of the security be registered or that the security be redeemed.

(m) “Registered form,” as applied to a certificated security, means a form in which:

(i) The security certificate specifies a person entitled to the security; and

(ii) A transfer of the security may be registered upon books maintained for that purpose by or on behalf of the issuer, or the security certificate so states.

(n) "Securities intermediary" means:

(i) A clearing corporation; or

(ii) A person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity.

(o) "Security," except as otherwise provided in section 28-8-103[, Idaho Code], means an obligation of an issuer or a share, participation or other interest in an issuer or in property or an enterprise of an issuer:

(i) Which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer;

(ii) Which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests or obligations; and

(iii) Which:

(A) Is, or is of a type, dealt in or traded on securities exchanges or securities markets; or

(B) Is a medium for investment and by its terms expressly provides that it is a security governed by this chapter.

(p) "Security certificate" means a certificate representing a security.

(q) "Security entitlement" means the rights and property interest of an entitlement holder with respect to a financial asset specified in part 5 of this chapter.

(r) "Uncertificated security" means a security that is not represented by a certificate.

(2) Other definitions applying to this chapter and the sections in which they appear are:

Appropriate person Section 28-8-107[, Idaho Code]

Control Section 28-8-106[, Idaho Code]

Delivery Section 28-8-301[, Idaho Code]

Investment company security Section 28-8-103[, Idaho Code]

Issuer Section 28-8-201[, Idaho Code]

Overissue Section 28-8-210[, Idaho Code]

Protected purchaser Section 28-8-303[, Idaho Code]

Securities account Section 28-8-501[, Idaho Code]

(3) In addition, chapter 1, title 28[, Idaho Code], contains general definitions and principles of construction and interpretation applicable throughout this chapter.

(4) The characterization of a person, business or transaction for purposes of this chapter does not determine the characterization of the person, business or transaction for purposes of any other law, regulation or rule.

History.

I.C., § 28-8-102, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-102 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertions throughout this section were added by the compiler to conform to the statutory citation style.

Official Comment

1. "Adverse claim." The definition of the term "adverse claim" has two components. First, the term refers only to property interests. Second, the term means not merely that a person has a property interest in a financial asset but that it is a violation of the claimant's property interest for the other person to hold or transfer the security or other financial asset.

The term adverse claim is not, of course, limited to ownership rights, but extends to other property interests established by other law. A security interest, for example, would be an adverse claim with respect to a transferee from the debtor since any effort by the secured party to enforce the security interest against the property would be an interference with the transferee's interest.

The definition of adverse claim in the prior version of Article 8 might have been read to suggest that any wrongful action concerning a security, even a simple breach of contract, gave rise to an adverse claim. Insofar as such cases as *Fallon v. Wall Street Clearing Corp.,* 586 N.Y.S.2d 953, 182 A.D.2d 245, (1992) and *Pentech Intl. v. Wall St. Clearing Co.,* 983 F.2d 441 (2d Cir. 1993), were based on that view, they are rejected by the new definition which explicitly limits the term adverse claim to property interests. Suppose, for example, that A contracts to sell or deliver securities to B, but fails to do so and instead sells or pledges the securities to C. B, the promisee, has an action against A for breach of contract, but absent unusual circumstances the action for breach would not give rise to a property interest in the securities. Accordingly, B does not have an adverse claim. An adverse claim might, however, be based upon principles of equitable remedies that give rise to property claims. It would, for example, cover a right established by other law to rescind a transaction in which securities were transferred. Suppose, for example, that A holds securities and is induced by B's fraud to transfer them to B. Under the law of contract or restitution, A may have a right to rescind the transfer, which gives A a property claim to the securities. If so, A has an adverse claim to the securities in B's hands. By contrast, if B had committed no fraud, but had merely committed a breach of contract in connection with the transfer from A to B, A may have only a right to damages for breach, not a right to rescind. In that case, A would not have an adverse claim to the securities in B's hands.

2. "Bearer form." The definition of "bearer form" has remained substantially unchanged since the early drafts of the original version of Article 8. The requirement that the certificate be payable to bearer by its terms rather than by an indorsement has the effect of preventing instruments governed by other law, such as chattel paper or Article 3 negotiable instruments, from being inadvertently swept into the Article 8 definition of

security merely by virtue of blank indorsements. Although the other elements of the definition of security in Section 8-102(a)(14) probably suffice for that purpose in any event, the language used in the prior version of Article 8 has been retained.

3. "Broker." Broker is defined by reference to the definitions of broker and dealer in the federal securities laws. The only difference is that banks, which are excluded from the federal securities law definition, are included in the Article 8 definition when they perform functions that would bring them within the federal securities law definition if it did not have the clause excluding banks. The definition covers both those who act as agents ("brokers" in securities parlance) and those who act as principals ("dealers" in securities parlance). Since the definition refers to persons "defined" as brokers or dealers under the federal securities law, rather than to persons required to "register" as brokers or dealers under the federal securities law, it covers not only registered brokers and dealers but also those exempt from the registration requirement, such as purely intrastate brokers. The only substantive rules that turn on the defined term broker are one provision of the section on warranties, Section 8-108(i), and the special perfection rule in Article 9 for security interests granted by brokers, Section 9-115(4)(c).

4. "Certificated security." The term "certificated security" means a security that is represented by a security certificate.

5. "Clearing corporation." The definition of clearing corporation limits its application to entities that are subject to a rigorous regulatory framework. Accordingly, the definition includes only federal reserve banks, persons who are registered as "clearing agencies" under the federal securities laws (which impose a comprehensive system of regulation of the activities and rules of clearing agencies), and other entities subject to a comparable system of regulatory oversight.

6. "Communicate." The term "communicate" assures that the Article 8 rules will be sufficiently flexible to adapt to changes in information technology. Sending a signed writing always suffices as a communication, but the parties can agree that a different means of transmitting information is to be used. Agreement is defined in Section 1-201(3) as "the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of

performance." Thus, use of an information transmission method might be found to be authorized by agreement, even though the parties have not explicitly so specified in a formal agreement. The term communicate is used in Sections 8-102(a)(7) (definition of entitlement order), 8-102(a)(11) (definition of instruction), and 8-403 (demand that issuer not register transfer).

7. "Entitlement holder." This term designates those who hold financial assets through intermediaries in the indirect holding system. Because many of the rules of Part 5 impose duties on securities intermediaries in favor of entitlement holders, the definition of entitlement holder is, in most cases, limited to the person specifically designated as such on the records of the intermediary. The last sentence of the definition covers the relatively unusual cases where a person may acquire a security entitlement under Section 8-501 even though the person may not be specifically designated as an entitlement holder on the records of the securities intermediary.

A person may have an interest in a security entitlement, and may even have the right to give entitlement orders to the securities intermediary with respect to it, even though the person is not the entitlement holder. For example, a person who holds securities through a securities account in its own name may have given discretionary trading authority to another person, such as an investment adviser. Similarly, the control provisions in Section 8-106 and the related provisions in Article 9 are designed to facilitate transactions in which a person who holds securities through a securities account uses them as collateral in an arrangement where the securities intermediary has agreed that if the secured party so directs the intermediary will dispose of the positions. In such arrangements, the debtor remains the entitlement holder but has agreed that the secured party can initiate entitlement orders. Moreover, an entitlement holder may be acting for another person as a nominee, agent, trustee, or in another capacity. Unless the entitlement holder is itself acting as a securities intermediary for the other person, in which case the other person would be an entitlement holder with respect to the securities entitlement, the relationship between an entitlement holder and another person for whose benefit the entitlement holder holds a securities entitlement is governed by other law.

8. "Entitlement order." This term is defined as a notification communicated to a securities intermediary directing transfer or redemption

of the financial asset to which an entitlement holder has a security entitlement. The term is used in the rules for the indirect holding system in a fashion analogous to the use of the terms "indorsement" and "instruction" in the rules for the direct holding system. If a person directly holds a certificated security in registered form and wishes to transfer it, the means of transfer is an indorsement. If a person directly holds an uncertificated security and wishes to transfer it, the means of transfer is an instruction. If a person holds a security entitlement, the means of disposition is an entitlement order. An entitlement order includes a direction under Section 8-508 to the securities intermediary to transfer a financial asset to the account of the entitlement holder at another financial intermediary or to cause the financial asset to be transferred to the entitlement holder in the direct holding system (e.g., the delivery of a securities certificate registered in the name of the former entitlement holder). As noted in Comment 7, an entitlement order need not be initiated by the entitlement holder in order to be effective, so long as the entitlement holder has authorized the other party to initiate entitlement orders. See Section 8-107(b).

9. "Financial asset." The definition of "financial asset," in conjunction with the definition of "securities account" in Section 8-501, sets the scope of the indirect holding system rules of Part 5 of Revised Article 8. The Part 5 rules apply not only to securities held through intermediaries, but also to other financial assets held through intermediaries. The term financial asset is defined to include not only securities but also a broader category of obligations, shares, participations, and interests.

Having separate definitions of security and financial asset makes it possible to separate the question of the proper scope of the traditional Article 8 rules from the question of the proper scope of the new indirect holding system rules. Some forms of financial assets should be covered by the indirect holding system rules of Part 5, but not by the rules of Parts 2, 3, and 4. The term financial asset is used to cover such property. Because the term security entitlement is defined in terms of financial assets rather than securities, the rules concerning security entitlements set out in Part 5 of Article 8 and in Revised Article 9 apply to the broader class of financial assets.

The fact that something does or could fall within the definition of financial asset does not, without more, trigger Article 8 coverage. The

indirect holding system rules of Revised Article 8 apply only if the financial asset is in fact held in a securities account, so that the interest of the person who holds the financial asset through the securities account is a security entitlement. Thus, questions of the scope of the indirect holding system rules cannot be framed as "Is such-and-such a 'financial asset' under Article 8?" Rather, one must analyze whether the relationship between an institution and a person on whose behalf the institution holds an asset falls within the scope of the term securities account as defined in Section 8-501. That question turns in large measure on whether it makes sense to apply the Part 5 rules to the relationship.

The term financial asset is used to refer both to the underlying asset and the particular means by which ownership of that asset is evidenced. Thus, with respect to a certificated security, the term financial asset may, as context requires, refer either to the interest or obligation of the issuer or to the security certificate representing that interest or obligation. Similarly, if a person holds a security or other financial asset through a securities account, the term financial asset may, as context requires, refer either to the underlying asset or to the person's security entitlement.

10. "Good faith." Good faith is defined in Article 8 for purposes of the application to Article 8 of Section 1-203, which provides that "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." The sole function of the good faith definition in Revised Article 8 is to give content to the Section 1-203 obligation as it applies to contracts and duties that are governed by Article 8. The standard is one of "reasonable commercial standards of fair dealing." The reference to commercial standards makes clear that assessments of conduct are to be made in light of the commercial setting. The substantive rules of Article 8 have been drafted to take account of the commercial circumstances of the securities holding and processing system. For example, Section 8-115 provides that a securities intermediary acting on an effective entitlement order, or a broker or other agent acting as a conduit in a securities transaction, is not liable to an adverse claimant, unless the claimant obtained legal process or the intermediary acted in collusion with the wrongdoer. This, and other similar provisions, see Sections 8-404 and 8-503(e), do not depend on notice of adverse claims, because it would impair rather than advance the interest of investors in having a sound and efficient

securities clearance and settlement system to require intermediaries to investigate the propriety of the transactions they are processing. The good faith obligation does not supplant the standards of conduct established in provisions of this kind.

In Revised Article 8, the definition of good faith is not germane to the question whether a purchaser takes free from adverse claims. The rules on such questions as whether a purchaser who takes in suspicious circumstances is disqualified from protected purchaser status are treated not as an aspect of good faith but directly in the rules of Section 8-105 on notice of adverse claims.

11. "Indorsement" is defined as a signature made on a security certificate or separate document for purposes of transferring or redeeming the security. The definition is adapted from the language of Section 8-308(1) of the prior version and from the definition of indorsement in the Negotiable Instruments Article, see Section 3-204(a). The definition of indorsement does not include the requirement that the signature be made by an appropriate person or be authorized. Those questions are treated in the separate substantive provision on whether the indorsement is effective, rather than in the definition of indorsement. See Section 8-107.

12. "Instruction" is defined as a notification communicated to the issuer of an uncertificated security directing that transfer be registered or that the security be redeemed. Instructions are the analog for uncertificated securities of indorsements of certificated securities.

13. "Registered form." The definition of "registered form" is substantially the same as in the prior version of Article 8. Like the definition of bearer form, it serves primarily to distinguish Article 8 securities from instruments governed by other law, such as Article 3.

Contrary to the holding in *Highland Capital Management LP v. Schneider*, 8 N.Y.3d 406 (2007), the registrability requirement in the definition of "registered form," and its parallel in the definition of "security," are satisfied only if books are maintained by or on behalf of the issuer for the purpose of registration of transfer, including the determination of rights under Section 8-207(a) (or if, in the case of a certificated security, the security certificate so states). It is not sufficient that the issuer records ownership, or records transfers thereof, for other purposes. Nor is it

sufficient that the issuer, while not in fact maintaining books for the purpose of registration of transfer, could do so, for such is always the case.

14. "Securities intermediary." A "securities intermediary" is a person that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity. The most common examples of securities intermediaries would be clearing corporations holding securities for their participants, banks acting as securities custodians, and brokers holding securities on behalf of their customers. Clearing corporations are listed separately as a category of securities intermediary in subparagraph (i) even though in most circumstances they would fall within the general definition in subparagraph (ii). The reason is to simplify the analysis of arrangements such as the NSCC-DTC system in which NSCC performs the comparison, clearance, and netting function, while DTC acts as the depository. Because NSCC is a registered clearing agency under the federal securities laws, it is a clearing corporation and hence a securities intermediary under Article 8, regardless of whether it is at any particular time or in any particular aspect of its operations holding securities on behalf of its participants.

The terms securities intermediary and broker have different meanings. Broker means a person engaged in the business of buying and selling securities, as agent for others or as principal. Securities intermediary means a person maintaining securities accounts for others. A stockbroker, in the colloquial sense, may or may not be acting as a securities intermediary.

The definition of securities intermediary includes the requirement that the person in question is "acting in the capacity" of maintaining securities accounts for others. This is to take account of the fact that a particular entity, such as a bank, may act in many different capacities in securities transactions. A bank may act as a transfer agent for issuers, as a securities custodian for institutional investors and private investors, as a dealer in government securities, as a lender taking securities as collateral, and as a provider of general payment and collection services that might be used in connection with securities transactions. A bank that maintains securities accounts for its customers would be a securities intermediary with respect to those accounts; but if it takes a pledge of securities from a borrower to secure a loan, it is not thereby acting as a securities intermediary with respect to the pledged securities, since it holds them for its own account

rather than for a customer. In other circumstances, those two functions might be combined. For example, if the bank is a government securities dealer it may maintain securities accounts for customers and also provide the customers with margin credit to purchase or carry the securities, in much the same way that brokers provide margin loans to their customers.

15. "Security." The definition of "security" has three components. First, there is the subparagraph (i) test that the interest or obligation be fully transferable, in the sense that the issuer either maintains transfer books or the obligation or interest is represented by a certificate in bearer or registered form. Second, there is the subparagraph (ii) test that the interest or obligation be divisible, that is, one of a class or series, as distinguished from individual obligations of the sort governed by ordinary contract law or by Article 3. Third, there is the subparagraph (iii) functional test, which generally turns on whether the interest or obligation is, or is of a type, dealt in or traded on securities markets or securities exchanges. There is, however, an "opt-in" provision in subparagraph (iii) which permits the issuer of any interest or obligation that is "a medium of investment" to specify that it is a security governed by Article 8.

The divisibility test of subparagraph (ii) applies to the security — that is, the underlying intangible interest — not the means by which that interest is evidenced. Thus, securities issued in book-entry only form meet the divisibility test because the underlying intangible interest is divisible via the mechanism of the indirect holding system. This is so even though the clearing corporation is the only eligible direct holder of the security.

The third component, the functional test in subparagraph (iii), provides flexibility while ensuring that the Article 8 rules do not apply to interests or obligations in circumstances so unconnected with the securities markets that parties are unlikely to have thought of the possibility that Article 8 might apply. Subparagraph (iii)(A) covers interests or obligations that either are dealt in or traded on securities exchanges or securities markets, or are of a type dealt in or traded on securities exchanges or securities markets. The "is dealt in or traded on" phrase eliminates problems in the characterization of new forms of securities which are to be traded in the markets, even though no similar type has previously been dealt in or traded in the markets. Subparagraph (iii)(B) covers the broader category of media for investment, but it applies only if the terms of the interest or obligation specify that it is

an Article 8 security. This opt-in provision allows for deliberate expansion of the scope of Article 8.

Section 8-103 contains additional rules on the treatment of particular interests as securities or financial assets.

16. "Security certificate." The term "security" refers to the underlying asset, e.g., 1000 shares of common stock of Acme, Inc. The term "security certificate" refers to the paper certificates that have traditionally been used to embody the underlying intangible interest.

17. "Security entitlement" means the rights and property interest of a person who holds securities or other financial assets through a securities intermediary. A security entitlement is both a package of personal rights against the securities intermediary and an interest in the property held by the securities intermediary. A security entitlement is not, however, a specific property interest in any financial asset held by the securities intermediary or by the clearing corporation through which the securities intermediary holds the financial asset. See Sections 8-104(c) and 8-503. The formal definition of security entitlement set out in subsection (a)(17) of this section is a cross-reference to the rules of Part 5. In a sense, then, the entirety of Part 5 is the definition of security entitlement. The Part 5 rules specify the rights and property interest that comprise a security entitlement.

18. "Uncertificated security." The term "uncertificated security" means a security that is not represented by a security certificate. For uncertificated securities, there is no need to draw any distinction between the underlying asset and the means by which a direct holder's interest in that asset is evidenced. Compare "certificated security" and "security certificate."

Definitional Cross References:

"Agreement". Section 1-201(b)(3).

"Bank". Section 1-201(b)(4).

"Person". Section 1-201(b)(27).

"Send". Section 1-201(b)(36).

"Signed". Section 1-201(b)(37).

"Writing". Section 1-201(b)(43).

§ 28-8-103. Rules for determining whether certain obligations and interests are securities or financial assets. — (1) A share or similar equity interest issued by a corporation, business trust, joint stock company or similar entity is a security.

(2) An "investment company security" is a security. "Investment company security" means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered, or a face-amount certificate issued by a face-amount certificate company that is so registered. Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

(3) An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this chapter, or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

(4) A writing that is a security certificate is governed by this chapter and not by chapter 3, title 28[, Idaho Code], even though it also meets the requirements of chapter 3, title 28[, Idaho Code]. However, a negotiable instrument governed by chapter 3, title 28[, Idaho Code], is a financial asset if it is held in a securities account.

(5) An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset.

(6) A commodity contract, as defined in section 28-9-102(a)(15)[, Idaho Code], is not a security or a financial asset.

(7) A document of title is not a financial asset unless section 28-8-102(1)(i)(iii)[, Idaho Code,] applies.

History.

I.C., § 28-8-103, as added by 1995, ch. 272, § 2, p. 873; am. 2001, ch. 208, § 14, p. 704; am. 2004, ch. 42, § 20, p. 77.

STATUTORY NOTES

Prior Laws.

Former § 28-8-103 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertions in subsections (4), (6), and (7) were added by the compiler to conform to the statutory citation style.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

Official Comment

1. This section contains rules that supplement the definitions of "financial asset" and "security" in Section 8-102. The Section 8-102 definitions are worded in general terms, because they must be sufficiently comprehensive and flexible to cover the wide variety of investment products that now exist or may develop. The rules in this section are intended to foreclose interpretive issues concerning the application of the general definitions to several specific investment products. No implication is made about the application of the Section 8-102 definitions to investment products not covered by this section.

2. Subsection (a) establishes an unconditional rule that ordinary corporate stock is a security. That is so whether or not the particular issue is dealt in or traded on securities exchanges or in securities markets. Thus, shares of closely held corporations are Article 8 securities.

3. Subsection (b) establishes that the Article 8 term "security" includes the various forms of the investment vehicles offered to the public by investment companies registered as such under the federal Investment Company Act of 1940, as amended. This clarification is prompted principally by the fact that the typical transaction in shares of open-end investment companies is an issuance or redemption, rather than a transfer of

shares from one person to another as is the case with ordinary corporate stock. For similar reasons, the definitions of indorsement, instruction, and entitlement order in Section 8-102 refer to "redemptions" as well as "transfers," to ensure that the Article 8 rules on such matters as signature guaranties, Section 8-306, assurances, Sections 8-402 and 8-507, and effectiveness, Section 8-107, apply to directions to redeem mutual fund shares. The exclusion of insurance products is needed because some insurance company separate accounts are registered under the Investment Company Act of 1940, but these are not traded under the usual Article 8 mechanics.

4. Subsection (c) is designed to foreclose interpretive questions that might otherwise be raised by the application of the "of a type" language of Section 8-102(a)(15)(iii) to partnership interests. Subsection (c) establishes the general rule that partnership interests or shares of limited liability companies are not Article 8 securities unless they are in fact dealt in or traded on securities exchanges or in securities markets. The issuer, however, may explicitly "opt-in" by specifying that the interests or shares are securities governed by Article 8. Partnership interests or shares of limited liability companies are included in the broader term "financial asset." Thus, if they are held through a securities account, the indirect holding system rules of Part 5 apply, and the interest of a person who holds them through such an account is a security entitlement.

5. Subsection (d) deals with the line between Article 3 negotiable instruments and Article 8 investment securities. It continues the rule of the prior version of Article 8 that a writing that meets the Article 8 definition is covered by Article 8 rather than Article 3, even though it also meets the definition of negotiable instrument. However, subsection (d) provides that an Article 3 negotiable instrument is a "financial asset" so that the indirect holding system rules apply if the instrument is held through a securities intermediary. This facilitates making items such as money market instruments eligible for deposit in clearing corporations.

6. Subsection (e) is included to clarify the treatment of investment products such as traded stock options, which are treated as financial assets but not securities. Thus, the indirect holding system rules of Part 5 apply, but the direct holding system rules of Parts 2, 3, and 4 do not.

7. Subsection (f) excludes commodity contracts from all of Article 8. However, under Article 9, commodity contracts are included in the definition of “investment property.” Therefore, the Article 9 rules on security interests in investment property do apply to security interests in commodity positions. See 9-102 and Comment 6 thereto. “Commodity contract” is defined in Section 9-102(a)(15).

8. Subsection (g) allows a document of title to be a financial asset and thus subject to the indirect holding system rules of Part 5 only to the extent that the intermediary and the person entitled under the document agree to do so. This is to prevent the inadvertent application of the Part 5 rules to intermediaries who may hold either electronic or tangible documents of title.

Definitional Cross References:

“Clearing corporation”. Section 8-102(a)(5).

“Commodity contract”. Section 9-102(a)(15).

“Financial asset”. Section 8-102(a)(9).

“Security”. Section 8-102(a)(15).

“Security certificate”. Section 8-102(a)(16).

§ 28-8-104. Acquisition of security or financial asset or interest therein.

— (1) A person acquires a security or an interest therein, under this chapter, if:

(a) The person is a purchaser to whom a security is delivered pursuant to section 28-8-301[, Idaho Code]; or (b) The person acquires a security entitlement to the security pursuant to section 28-8-501[, Idaho Code].

(2) A person acquires a financial asset, other than a security, or an interest therein, under this chapter, if the person acquires a security entitlement to the financial asset.

(3) A person who acquires a security entitlement to a security or other financial asset has the rights specified in part 5 of this chapter, but is a purchaser of any security, security entitlement, or other financial asset held by the securities intermediary only to the extent provided in section 28-8-503[, Idaho Code].

(4) Unless the context shows that a different meaning is intended, a person who is required by other law, regulation, rule or agreement to transfer, deliver, present, surrender, exchange or otherwise put in the possession of another person a security or financial asset satisfies that requirement by causing the other person to acquire an interest in the security or financial asset pursuant to subsection (1) or (2) of this section.

History.

I.C., § 28-8-104, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-104 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertions in paragraphs (1)(a) and (1)(b) and subsection (3) were added by the compiler to conform to the statutory citation style.

Official Comment

1. This section lists the ways in which interests in securities and other financial assets are acquired under Article 8. In that sense, it describes the scope of Article 8. Subsection (a) describes the two ways that a person may acquire a security or interest therein under this Article: (1) by delivery (Section 8-301), and (2) by acquiring a security entitlement. Each of these methods is described in detail in the relevant substantive provisions of this Article. Part 3, beginning with the definition of "delivery" in Section 8-301, describes how interests in securities are acquired in the direct holding system. Part 5, beginning with the rules of Section 8-501 on how security entitlements are acquired, describes how interests in securities are acquired in the indirect holding system.

Subsection (b) specifies how a person may acquire an interest under Article 8 in a financial asset other than a security. This Article deals with financial assets other than securities only insofar as they are held in the indirect holding system. For example, a banker's acceptance falls within the definition of "financial asset," so if it is held through a securities account the entitlement holder's right to it is a security entitlement governed by Part 5. The bankers' acceptance itself, however, is a negotiable instrument governed by Article 3, not by Article 8. Thus, the provisions of Parts 2, 3, and 4 of this Article that deal with the rights of direct holders of securities are not applicable. Article 3, not Article 8, specifies how one acquires a direct interest in a bankers' acceptance. If a bankers' acceptance is delivered to a clearing corporation to be held for the account of the clearing corporation's participants, the clearing corporation becomes the holder of the bankers' acceptance under the Article 3 rules specifying how negotiable instruments are transferred. The rights of the clearing corporation's participants, however, are governed by Part 5 of this Article.

2. The distinction in usage in Article 8 between the term "security" (and its correlatives "security certificate" and "uncertificated security") on the one hand, and "security entitlement" on the other, corresponds to the distinction between the direct and indirect holding systems. For example, with respect to certificated securities that can be held either directly or through intermediaries, obtaining possession of a security certificate and acquiring a security entitlement are both means of holding the underlying

security. For many other purposes, there is no need to draw a distinction between the means of holding. For purposes of commercial law analysis, however, the form of holding may make a difference. Where an item of property can be held in different ways, the rules on how one deals with it, including how one transfers it or how one grants a security interest in it, differ depending on the form of holding.

Although a security entitlement is means of holding the underlying security or other financial asset, a person who has a security entitlement does not have any direct claim to a specific asset in the possession of the securities intermediary. Subsection (c) provides explicitly that a person who acquires a security entitlement is a "purchaser" of any security, security entitlement, or other financial asset held by the securities intermediary only in the sense that under Section 8-503 a security entitlement is treated as a *sui generis* form of property interest.

3. Subsection (d) is designed to ensure that parties will retain their expected legal rights and duties under Revised Article 8. One of the major changes made by the revision is that the rules for the indirect holding system are stated in terms of the "security entitlements" held by investors, rather than speaking of them as holding direct interests in securities. Subsection (d) is designed as a translation rule to eliminate problems of co-ordination of terminology, and facilitate the continued use of systems for the efficient handling of securities and financial assets through securities intermediaries and clearing corporations. The efficiencies of a securities intermediary or clearing corporation are, in part, dependent on the ability to transfer securities credited to securities accounts in the intermediary or clearing corporation to the account of an issuer, its agent, or other person by book entry in a manner that permits exchanges, redemptions, conversions, and other transactions (which may be governed by pre-existing or new agreements, constitutional documents, or other instruments) to occur and to avoid the need to withdraw from immobilization in an intermediary or clearing corporation physical securities in order to deliver them for such purposes. Existing corporate charters, indentures and like documents may require the "presentation," "surrender," "delivery," or "transfer" of securities or security certificates for purposes of exchange, redemption, conversion or other reason. Likewise, documents may use a wide variety of terminology to describe, in the context for example of a tender or exchange

offer, the means of putting the offeror or the issuer or its agent in possession of the security. Subsection (d) takes the place of provisions of prior law which could be used to reach the legal conclusion that book-entry transfers are equivalent to physical delivery to the person to whose account the book entry is credited.

Definitional Cross References: “Delivery”. Section 8-301.

“Financial asset”. Section 8-102(a)(9).

“Person”. Section 1-201(30).

“Purchaser”. Sections 1-201(30) & 8-116.

“Security”. Section 8-102(a)(15).

“Security entitlement”. Section 8-102(a)(17).

§ 28-8-105. Notice of adverse claim. — (1) A person has notice of an adverse claim if:

(a) The person knows of the adverse claim;

(b) The person is aware of facts sufficient to indicate that there is a significant probability that the adverse claim exists and deliberately avoids information that would establish the existence of the adverse claim; or

(c) The person has a duty, imposed by statute or rule, to investigate whether an adverse claim exists, and the investigation so required would establish the existence of the adverse claim.

(2) Having knowledge that a financial asset or interest therein is or has been transferred by a representative imposes no duty of inquiry into the rightfulness of a transaction and is not notice of an adverse claim. However, a person who knows that a representative has transferred a financial asset or interest therein in a transaction that is, or whose proceeds are being used, for the individual benefit of the representative or otherwise in breach of duty has notice of an adverse claim.

(3) An act or event that creates a right to immediate performance of the principal obligation represented by a security certificate or sets a date on or after which the certificate is to be presented or surrendered for redemption or exchange does not itself constitute notice of an adverse claim except in the case of a transfer more than:

(a) One (1) year after a date set for presentment or surrender for redemption or exchange; or

(b) Six (6) months after a date set for payment of money against presentation or surrender of the certificate, if money was available for payment on that date.

(4) A purchaser of a certificated security has notice of an adverse claim if the security certificate:

(a) Whether in bearer or registered form, has been indorsed "for collection" or "for surrender" or for some other purpose not involving

transfer; or

(b) Is in bearer form and has on it an unambiguous statement that it is the property of a person other than the transferor, but the mere writing of a name on the certificate is not such a statement.

(5) Filing of a financing statement under chapter 9, title 28[, Idaho Code], is not notice of an adverse claim to a financial asset.

History.

I.C., § 28-8-105, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-105 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertion in subsection (5) was added by the compiler to conform to the statutory citation style.

Official Comment

1. The rules specifying whether adverse claims can be asserted against persons who acquire securities or security entitlements, Sections 8-303, 8-502, and 8-510, provide that one is protected against an adverse claim only if one takes without notice of the claim. This section defines notice of an adverse claim.

The general Article 1 definition of "notice" in Section 1-201(25) — which provides that a person has notice of a fact if "from all the facts and circumstances known to him at the time in question he has reason to know that it exists" — does not apply to the interpretation of "notice of adverse claims." The Section 1-201(25) definition of "notice" does, however, apply to usages of that term and its cognates in Article 8 in contexts other than notice of adverse claims.

2. This section must be interpreted in light of the definition of "adverse claim" in Section 8-102(a)(1). "Adverse claim" does not include all circumstances in which a third party has a property interest in securities, but

only those situations where a security is transferred in violation of the claimant's property interest. Therefore, awareness that someone other than the transferor has a property interest is not notice of an adverse claim. The transferee must be aware that the transfer violates the other party's property interest. If A holds securities in which B has some form of property interest, and A transfers the securities to C, C may know that B has an interest, but infer that A is acting in accordance with A's obligations to B. The mere fact that C knew that B had a property interest does not mean that C had notice of an adverse claim. Whether C had notice of an adverse claim depends on whether C had sufficient awareness that A was acting in violation of B's property rights. The rule in subsection (b) is a particularization of this general principle.

3. Paragraph (a)(1) provides that a person has notice of an adverse claim if the person has knowledge of the adverse claim. Knowledge is defined in Section 1-201(25) as actual knowledge.

4. Paragraph (a)(2) provides that a person has notice of an adverse claim if the person is aware of a significant probability that an adverse claim exists and deliberately avoids information that might establish the existence of the adverse claim. This is intended to codify the "willful blindness" test that has been applied in such cases. See *May v. Chapman*, 16 M. & W. 355, 153 Eng. Rep. 1225 (1847); *Goodman v. Simonds*, 61 U.S. 343 (1857).

The first prong of the willful blindness test of paragraph (a)(2) turns on whether the person is aware facts sufficient to indicate that there is a significant probability that an adverse claim exists. The "awareness" aspect necessarily turns on the actor's state of mind. Whether facts known to a person make the person aware of a "significant probability" that an adverse claim exists turns on facts about the world and the conclusions that would be drawn from those facts, taking account of the experience and position of the person in question. A particular set of facts might indicate a significant probability of an adverse claim to a professional with considerable experience in the usual methods and procedures by which securities transactions are conducted, even though the same facts would not indicate a significant probability of an adverse claim to a nonprofessional.

The second prong of the willful blindness test of paragraph (a)(2) turns on whether the person "deliberately avoids information" that would

establish the existence of the adverse claim. The test is the character of the person's response to the information the person has. The question is whether the person deliberately failed to seek further information because of concern that suspicions would be confirmed.

Application of the "deliberate avoidance" test to a transaction by an organization focuses on the knowledge and the actions of the individual or individuals conducting the transaction on behalf of the organization. Thus, an organization that purchases a security is not willfully blind to an adverse claim unless the officers or agents who conducted that purchase transaction are willfully blind to the adverse claim. Under the two prongs of the willful blindness test, the individual or individuals conducting a transaction must know of facts indicating a substantial probability that the adverse claim exists and deliberately fail to seek further information that might confirm or refute the indication. For this purpose, information known to individuals within an organization who are not conducting or aware of a transaction, but not forwarded to the individuals conducting the transaction, is not pertinent in determining whether the individuals conducting the transaction had knowledge of a substantial probability of the existence of the adverse claim. Cf. Section 1-201(27). An organization may also "deliberately avoid information" if it acts to preclude or inhibit transmission of pertinent information to those individuals responsible for the conduct of purchase transactions.

5. Paragraph (a)(3) provides that a person has notice of an adverse claim if the person would have learned of the adverse claim by conducting an investigation that is required by other statute or regulation. This rule applies only if there is some other statute or regulation that explicitly requires persons dealing with securities to conduct some investigation. The federal securities laws require that brokers and banks, in certain specified circumstances, check with a stolen securities registry to determine whether securities offered for sale or pledge have been reported as stolen. If securities that were listed as stolen in the registry are taken by an institution that failed to comply with requirement to check the registry, the institution would be held to have notice of the fact that they were stolen under paragraph (a)(3). Accordingly, the institution could not qualify as a protected purchaser under Section 8-303. The same result has been reached

under the prior version of Article 8. See *First Nat'l Bank of Cicero v. Lewco Securities*, 860 F.2d 1407 (7th Cir. 1988).

6. Subsection (b) provides explicitly for some situations involving purchase from one described or identifiable as a representative. Knowledge of the existence of the representative relation is not enough in itself to constitute "notice of an adverse claim" that would disqualify the purchaser from protected purchaser status. A purchaser may take a security on the inference that the representative is acting properly. Knowledge that a security is being transferred to an individual account of the representative or that the proceeds of the transaction will be paid into that account is not sufficient to constitute "notice of an adverse claim," but knowledge that the proceeds will be applied to the personal indebtedness of the representative is. See *State Bank of Binghamton v. Bache*, 162 Misc. 128, 293 N.Y.S. 667 (1937).

7. Subsection (c) specifies whether a purchaser of a "stale" security is charged with notice of adverse claims, and therefore disqualified from protected purchaser status under Section 8-303. The fact of "staleness" is viewed as notice of certain defects after the lapse of stated periods, but the maturity of the security does not operate automatically to affect holders' rights. The periods of time here stated are shorter than those appearing in the provisions of this Article on staleness as notice of defects or defenses of an issuer (Section 8-203) since a purchaser who takes a security after funds or other securities are available for its redemption has more reason to suspect claims of ownership than issuer's defenses. An owner will normally turn in a security rather than transfer it at such a time. Of itself, a default never constitutes notice of a possible adverse claim. To provide otherwise would not tend to drive defaulted securities home and would serve only to disrupt current financial markets where many defaulted securities are actively traded. Unpaid or overdue coupons attached to a bond do not bring it within the operation of this subsection, though they may be relevant under the general test of notice of adverse claims in subsection (a).

8. Subsection (d) provides the owner of a certificated security with a means of protection while a security certificate is being sent in for redemption or exchange. The owner may endorse it "for collection" or "for surrender," and this constitutes notice of the owner's claims, under subsection (d).

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1).

"Bearer form". Section 8-102(a)(2).

"Certificated security". Section 8-102(a)(4).

"Financial asset". Section 8-102(a)(9).

"Knowledge". Section 1-201(25).

"Person". Section 1-201(30).

"Purchaser". Sections 1-201(30) & 8-116.

"Registered form". Section 8-102(a)(13).

"Representative". Section 1-201(35).

"Security certificate". Section 8-102(a)(16).

§ 28-8-106. Control. — (1) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(2) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(a) The certificate is indorsed to the purchaser or in blank by an effective indorsement; or

(b) The certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(3) A purchaser has "control" of an uncertificated security if:

(a) The uncertificated security is delivered to the purchaser; or

(b) The issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(4) A purchaser has "control" of a security entitlement if:

(a) The purchaser becomes the entitlement holder;

(b) The securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder; or

(c) Another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser.

(5) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(6) A purchaser who has satisfied the requirements of subsection (3) or (4) of this section has control, even if the registered owner in the case of subsection (3) of this section, or the entitlement holder in the case of subsection (4) of this section, retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or

entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(7) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (3)(b) or (4)(b) of this section without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

History.

I.C., § 28-8-106, as added by 1995, ch. 272, § 2, p. 873; am. 2001, ch. 208, § 15, p. 704.

STATUTORY NOTES

Prior Laws.

Former § 28-8-106 was repealed. See Prior Laws, § 28-8-101.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

CASE NOTES

Decisions Under Prior Law

Analysis

Joint Tenants.

Where there are two listed owners, the requirement that the new owners personally receive physical possession of the reissued stock certificates to constitute a valid transfer is not applicable because both joint tenants cannot

enjoy possession simultaneously. Ogilvie v. Idaho Bank & Trust Co., 99 Idaho 361, 582 P.2d 215 (1978).

Satisfaction of Requirements.

The "indorsement" and "delivery" requirements were satisfied when stock certificates were indorsed and delivered to the issuer with instructions to list the purchaser as a joint tenant. Ogilvie v. Idaho Bank & Trust Co., 99 Idaho 361, 582 P.2d 215 (1978).

Official Comment

1. The concept of "control" plays a key role in various provisions dealing with the rights of purchasers, including secured parties. See Sections 8-303 (protected purchaser); 8-503(e) (purchasers from securities intermediaries); 8-510 (purchasers of security entitlements from entitlement holders); 9-314 (perfection of security interests); 9-328 (priorities among conflicting security interests).

Obtaining "control" means that the purchaser has taken whatever steps are necessary, given the manner in which the securities are held, to place itself in a position where it can have the securities sold, without further action by the owner.

2. Subsection (a) provides that a purchaser obtains "control" with respect to a certificated security in bearer form by taking "delivery," as defined in Section 8-301. Subsection (b) provides that a purchaser obtains "control" with respect to a certificated security in registered form by taking "delivery," as defined in Section 8-301, provided that the security certificate has been indorsed to the purchaser or in blank. Section 8-301 provides that delivery of a certificated security occurs when the purchaser obtains possession of the security certificate, or when an agent for the purchaser (other than a securities intermediary) either acquires possession or acknowledges that the agent holds for the purchaser.

3. Subsection (c) specifies the means by which a purchaser can obtain control over uncertificated securities which the transferor holds directly. Two mechanisms are possible.

Under subsection (c)(1), securities can be "delivered" to a purchaser. Section 8-301(b) provides that "delivery" of an uncertificated security

occurs when the purchaser becomes the registered holder. So far as the issuer is concerned, the purchaser would then be entitled to exercise all rights of ownership. See Section 8-207. As between the parties to a purchase transaction, however, the rights of the purchaser are determined by their contract. Cf. Section 9-202. Arrangements covered by this paragraph are analogous to arrangements in which bearer certificates are delivered to a secured party — so far as the issuer or any other parties are concerned, the secured party appears to be the outright owner, although it is in fact holding as collateral property that belongs to the debtor.

Under subsection (c)(2), a purchaser has control if the issuer has agreed to act on the instructions of the purchaser, even though the owner remains listed as the registered owner. The issuer, of course, would be acting wrongfully against the registered owner if it entered into such an agreement without the consent of the registered owner. Subsection (g) makes this point explicit. The subsection (c)(2) provision makes it possible for issuers to offer a service akin to the registered pledge device of the 1978 version of Article 8, without mandating that all issuers offer that service.

4. Subsection (d) specifies the means by which a purchaser can obtain control of a security entitlement. Three mechanisms are possible, analogous to those provided in subsection (c) for uncertificated securities. Under subsection (d)(1), a purchaser has control if it is the entitlement holder. This subsection would apply whether the purchaser holds through the same intermediary that the debtor used, or has the securities position transferred to its own intermediary. Subsection (d)(2) provides that a purchaser has control if the securities intermediary has agreed to act on entitlement orders originated by the purchaser if no further consent by the entitlement holder is required. Under subsection (d)(2), control may be achieved even though the original entitlement holder remains as the entitlement holder. Finally, a purchaser may obtain control under subsection (d)(3) if another person has control and the person acknowledges that it has control on the purchaser's behalf. Control under subsection (d)(3) parallels the delivery of certificated securities and uncertificated securities under Section 8-301. Of course, the acknowledging person cannot be the debtor.

This section specifies only the minimum requirements that such an arrangement must meet to confer "control"; the details of the arrangement can be specified by agreement. The arrangement might cover all of the

positions in a particular account or subaccount, or only specified positions. There is no requirement that the control party's right to give entitlement orders be exclusive. The arrangement might provide that only the control party can give entitlement orders, or that either the entitlement holder or the control party can give entitlement orders. See subsection (f).

The following examples illustrate the application of subsection (d):

Example 1. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha also has an account with Able. Debtor instructs Able to transfer the shares to Alpha, and Able does so by crediting the shares to Alpha's account. Alpha has control of the 1000 shares under subsection (d)(1). Although Debtor may have become the beneficial owner of the new securities entitlement, as between Debtor and Alpha, Able has agreed to act on Alpha's entitlement orders because, as between Able and Alpha, Alpha has become the entitlement holder. See Section 8-506.

Example 2. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Alpha does not have an account with Able. Alpha uses Beta as its securities custodian. Debtor instructs Able to transfer the shares to Beta, for the account of Alpha, and Able does so. Alpha has control of the 1000 shares under subsection (d)(1). As in Example 1, although Debtor may have become the beneficial owner of the new securities entitlement, as between Debtor and Alpha, Beta has agreed to act on Alpha's entitlement orders because, as between Beta and Alpha, Alpha has become the entitlement holder.

Example 3. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Debtor, Able, and Alpha enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Alpha also has the right to dispositions. Alpha has control of the 1000 shares under subsection (d)(2).

Example 4. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co.

stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Alpha's account at Clearing Corporation. As in Example 1, Alpha has control of the 1000 shares under subsection (d)(1).

Example 5. Able & Co., a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Alpha does not have a account with Clearing Corporation. It holds its securities through Beta Bank, which does have an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into Beta's account at Clearing Corporation. Beta credits the position to Alpha's account with Beta. As in Example 2, Alpha has control of the 1000 shares under subsection (d)(1).

Example 6. Able & Co. a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able causes Clearing Corporation to transfer the shares into a pledge account, pursuant to an agreement under which Able will continue to receive dividends, distributions, and the like, but Alpha has the right to direct dispositions. As in Example 3, Alpha has control of the 1000 shares under subsection (d)(2).

Example 7. Able & Co. a securities dealer, grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Able holds through an account with Clearing Corporation. Able, Alpha, and Clearing Corporation enter into an agreement under which Clearing Corporation will act on instructions from Alpha with respect to the XYZ Co. stock carried in Able's account, but Able will continue to receive dividends, distributions, and the like, and will also have the right to direct dispositions. As in Example 3, Alpha has control of the 1000 shares under subsection (d)(2).

Example 8. Able & Co., a securities dealer, holds a wide range of securities through its account at Clearing Corporation. Able enters into an arrangement with Alpha Bank pursuant to which Alpha provides financing to Able secured by securities identified as the collateral on lists provided by Able to Alpha on a daily or other periodic basis. Able, Alpha, and Clearing

Corporation enter into an agreement under which Clearing Corporation agrees that if at any time Alpha directs Clearing Corporation to do so, Clearing Corporation will transfer any securities from Able's account at Alpha's instructions. Because Clearing Corporation has agreed to act on Alpha's instructions with respect to any securities carried in Able's account, at the moment that Alpha's security interest attaches to securities listed by Able, Alpha obtains control of those securities under subsection (d)(2). There is no requirement that Clearing Corporation be informed of which securities Able has pledged to Alpha.

Example 9. Debtor grants Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Beta Bank agrees with Alpha to act as Alpha's collateral agent with respect to the security entitlement. Debtor, Able, and Beta enter into an agreement under which Debtor will continue to receive dividends and distributions, and will continue to have the right to direct dispositions, but Beta also has the right to direct dispositions. Because Able has agreed that it will comply with entitlement orders originated by Beta without further consent by Debtor, Beta has control of the security entitlement (see Example 3). Because Beta has control on behalf of Alpha, Alpha also has control under subsection (d)(3). It is not necessary for Able to enter into an agreement directly with Alpha or for Able to be aware of Beta's relationship with Alpha.

5. For a purchaser to have "control" under subsection (c)(2) or (d)(2), it is essential that the issuer or securities intermediary, as the case may be, actually be a party to the agreement. If a debtor gives a secured party a power of attorney authorizing the secured party to act in the name of the debtor, but the issuer or securities intermediary does not specifically agree to this arrangement, the secured party does not have "control" within the meaning of subsection (c)(2) or (d)(2) because the issuer or securities intermediary is not a party to the agreement. The secured party does not have control under subsection (c)(1) or (d)(1) because, although the power of attorney might give the secured party authority to act on the debtor's behalf as an agent, the secured party has not actually become the registered owner or entitlement holder.

6. Subsection (e) provides that if an interest in a security entitlement is granted by an entitlement holder to the securities intermediary through

which the security entitlement is maintained, the securities intermediary has control. A common transaction covered by this provision is a margin loan from a broker to its customer.

7. The term "control" is used in a particular defined sense. The requirements for obtaining control are set out in this section. The concept is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) or (d)(2). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.

The key to the control concept is that the purchaser has the ability to have the securities sold or transferred without further action by the transferor. There is no requirement that the powers held by the purchaser be exclusive. For example, in a secured lending arrangement, if the secured party wishes, it can allow the debtor to retain the right to make substitutions, to direct the disposition of the uncertificated security or security entitlement, or otherwise to give instructions or entitlement orders. (As explained in Section 8-102, Comment 8, an entitlement order includes a direction under Section 8-508 to the securities intermediary to transfer a financial asset to the account of the entitlement holder of another financial intermediary or to cause the financial asset to be transferred to the entitlement holder in the direct holding system (e.g., by delivery of a securities certificate registered in the name of the former entitlement holder).) Subsection (f) is included to make clear the general point stated in subsections (c) and (d) that the test of control is whether the purchaser has obtained the requisite power, not whether the debtor has retained other powers. There is no implication that retention by the debtor of powers other than those mentioned in subsection (f) is inconsistent with the purchaser having control. Nor is there a requirement that the purchaser's powers be unconditional, provided that further consent of the entitlement holder is not a condition.

Example 10. Debtor grants to Alpha Bank and to Beta Bank a security interest in a security entitlement that includes the 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. By agreement

among the parties, Alpha security interest is senior and Beta's is junior. Able agrees to act on the entitlement orders of either Alpha or Beta. Alpha and Beta each has control under subsection (d)(2). Moreover, Beta has control notwithstanding a term of Able's agreement to the effect that Able's obligation to act on Beta's entitlement orders is conditioned on Alpha's consent. The crucial distinction is that Able's agreement to act on Beta's entitlement orders is not conditioned on Debtor's further consent.

Example 11. Debtor grants to Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Able agrees to act on the entitlement orders of Alpha, but Alpha's right to give entitlement orders to the securities intermediary is conditioned on the Debtor's default. Alternatively, Alpha's right to give entitlement orders is conditioned upon Alpha's statement to Able that Debtor is in default. Because Able's agreement to act on Alpha's entitlement orders is not conditioned on Debtor's further consent, Alpha has control of the securities entitlement under either alternative.

In many situations, it will be better practice for both the securities intermediary and the purchaser to insist that any conditions relating to any way to the entitlement holder be effective only as between the purchaser and the entitlement holder. That practice would avoid the risk that the securities intermediary could be caught between conflicting assertions of the entitlement holder and the purchaser as to whether the conditions in fact have been met. Nonetheless, the existence of unfulfilled conditions effective against the intermediary would not preclude the purchaser from having control.

Definitional Cross References:

"Bearer form". Section 8-102(a)(2).

"Certificated security". Section 8-102(a)(4).

"Delivery". Section 8-301.

"Effective". Section 8-107.

"Entitlement holder". Section 8-102(a)(7).

"Entitlement order". Section 8-102(a)(8).

"Indorsement". Section 8-102(a)(11).

"Instruction". Section 8-102(a)(12).

"Purchaser". Sections 1-201(30) & 8-116.

"Registered form". Section 8-102(a)(13).

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-107. Whether indorsement, instruction or entitlement order is effective. — (1) "Appropriate person" means:

(a) With respect to an indorsement, the person specified by a security certificate or by an effective special indorsement to be entitled to the security;

(b) With respect to an instruction, the registered owner of an uncertificated security;

(c) With respect to an entitlement order, the entitlement holder;

(d) If the person designated in paragraph (a), (b) or (c) of this subsection is deceased, the designated person's successor taking under other law or the designated person's personal representative acting for the estate of the decedent; or

(e) If the person designated in paragraph (a), (b) or (c) of this subsection lacks capacity, the designated person's guardian, conservator or other similar representative who has power under other law to transfer the security or financial asset.

(2) An indorsement, instruction, or entitlement order is effective if:

(a) It is made by the appropriate person;

(b) It is made by a person who has power under the law of agency to transfer the security or financial asset on behalf of the appropriate person, including, in the case of an instruction or entitlement order, a person who has control under section 28-8-106(3)(b) or (4)(b)[, Idaho Code]; or

(c) The appropriate person has ratified it or is otherwise precluded from asserting its ineffectiveness.

(3) An indorsement, instruction or entitlement order made by a representative is effective even if:

(a) The representative has failed to comply with a controlling instrument or with the law of the state having jurisdiction of the representative relationship, including any law requiring the representative to obtain court approval of the transaction; or

(b) The representative's action in making the indorsement, instruction or entitlement order or using the proceeds of the transaction is otherwise a breach of duty.

(4) If a security is registered in the name of or specially indorsed to a person described as a representative, or if a securities account is maintained in the name of a person described as a representative, an indorsement, instruction or entitlement order made by the person is effective even though the person is no longer serving in the described capacity.

(5) Effectiveness of an indorsement, instruction or entitlement order is determined as of the date the indorsement, instruction or entitlement order is made, and an indorsement, instruction or entitlement order does not become ineffective by reason of any later change of circumstances.

History.

I.C., § 28-8-107, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-107 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertion at the end of paragraph (2)(b) was added by the compiler to conform to the statutory citation style.

Official Comment

1. This section defines two concepts, "appropriate person" and "effective." Effectiveness is a broader concept than appropriate person. For example, if a security or securities account is registered in the name of Mary Roe, Mary Roe is the "appropriate person," but an indorsement, instruction, or entitlement order made by John Doe is "effective" if, under agency or other law, Mary Roe is precluded from denying Doe's authority. Treating these two concepts separately facilitates statement of the rules of Article 8 that state the legal effect of an indorsement, instruction, or entitlement order. For example, a securities intermediary is protected against liability if it acts on an effective entitlement order, but has a duty to

comply with an entitlement order only if it is originated by an appropriate person. See Sections 8-115 and 8-507.

One important application of the "effectiveness" concept is in the direct holding system rules on the rights of purchasers. A purchaser of a certificated security in registered form can qualify as a protected purchaser who takes free from adverse claims under Section 8-303 only if the purchaser obtains "control." Section 8-106 provides that a purchaser of a certificated security in registered form obtains control if there has been an "effective indorsement."

2. Subsection (a) provides that the term "appropriate person" covers two categories: (1) the person who is actually designated as the person entitled to the security or security entitlement, and (2) the successor or legal representative of that person if that person has died or otherwise lacks capacity. Other law determines who has power to transfer a security on behalf of a person who lacks capacity. For example, if securities are registered in the name of more than one person and one of the designated persons dies, whether the survivor is the appropriate person depends on the form of tenancy. If the two were registered joint tenants with right of survivorship, the survivor would have that power under other law and thus would be the "appropriate person." If securities are registered in the name of an individual and the individual dies, the law of decedents' estates determines who has power to transfer the decedent's securities. That would ordinarily be the executor or administrator, but if a "small estate statute" permits a widow to transfer a decedent's securities without administration proceedings, she would be the appropriate person. If the registration of a security or a securities account contains a designation of a death beneficiary under the Uniform Transfer on Death Security Registration Act or comparable legislation, the designated beneficiary would, under that law, have power to transfer upon the person's death and so would be the appropriate person. Article 8 does not contain a list of such representatives, because any list is likely to become outdated by developments in other law.

3. Subsection (b) sets out the general rule that an indorsement, instruction, or entitlement order is effective if it is made by the appropriate person or by a person who has power to transfer under agency law or if the appropriate person is precluded from denying its effectiveness. The control rules in Section 8-106 provide for arrangements where a person who holds

securities through a securities intermediary, or holds uncertificated securities directly, enters into a control agreement giving the secured party the right to initiate entitlement orders of instructions. Paragraph 2 of subsection (b) states explicitly that an entitlement order or instruction initiated by a person who has obtained such a control agreement is "effective."

Subsections (c), (d), and (e) supplement the general rule of subsection (b) on effectiveness. The term "representative," used in subsections (c) and (d), is defined in Section 1-201(35).

4. Subsection (c) provides that an indorsement, instruction, or entitlement order made by a representative is effective even though the representative's action is a violation of duties. The following example illustrates this subsection:

Example 1. Certificated securities are registered in the name of John Doe. Doe dies and Mary Roe is appointed executor. Roe indorses the security certificate and transfers it to a purchaser in a transaction that is a violation of her duties as executor.

Roe's indorsement is effective, because Roe is the appropriate person under subsection (a)(4). This is so even though Roe's transfer violated her obligations as executor. The policies of free transferability of securities that underlie Article 8 dictate that neither a purchaser to whom Roe transfers the securities nor the issuer who registers transfer should be required to investigate the terms of the will to determine whether Roe is acting properly. Although Roe's indorsement is effective under this section, her breach of duty may be such that her beneficiary has an adverse claim to the securities that Roe transferred. The question whether that adverse claim can be asserted against purchasers is governed not by this section but by Section 8-303. Under Section 8-404, the issuer has no duties to an adverse claimant unless the claimant obtains legal process enjoining the issuer from registering transfer.

5. Subsection (d) deals with cases where a security or a securities account is registered in the name of a person specifically designated as a representative. The following example illustrates this subsection:

Example 2. Certificated securities are registered in the name of "John Jones, trustee of the Smith Family Trust." John Jones is removed as trustee and Martha Moe is appointed successor trustee. The securities, however, are not reregistered, but remain registered in the name of "John Jones, trustee of the Smith Family Trust." Jones indorses the security certificate and transfers it to a purchaser.

Subsection (d) provides that an indorsement by John Jones as trustee is effective even though Jones is no longer serving in that capacity. Since the securities were registered in the name of "John Jones, trustee of the Smith Family Trust," a purchaser, or the issuer when called upon to register transfer, should be entitled to assume without further inquiry that Jones has the power to act as trustee for the Smith Family Trust.

Note that subsection (d) does not apply to a case where the security or securities account is registered in the name of principal rather than the representative as such. The following example illustrates this point:

Example 3. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. The securities are not reregistered in the name of Mary Roe as executor. Later, Mary Roe is removed as executor and Martha Moe is appointed as her successor. After being removed, Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser.

Mary Roe's indorsement is not made effective by subsection (d), because the securities were not registered in the name of Mary Roe as representative. A purchaser or the issuer registering transfer should be required to determine whether Roe has power to act for John Doe. Purchasers and issuers can protect themselves in such cases by requiring signature guaranties. See Section 8-306.

6. Subsection (e) provides that the effectiveness of an indorsement, instruction, or entitlement order is determined as of the date it is made. The following example illustrates this subsection.

Example 4. Certificated securities are registered in the name of John Doe. John Doe dies and Mary Roe is appointed executor. Mary Roe indorses the security certificate that is registered in the name of John Doe and transfers it to a purchaser. After the indorsement and transfer, but before the security

certificate is presented to the issuer for registration of transfer, Mary Roe is removed as executor and Martha Moe is appointed as her successor.

Mary Roe's indorsement is effective, because at the time Roe indorsed she was the appropriate person under subsection (a)(4). Her later removal as executor does not render the indorsement ineffective. Accordingly, the issuer would not be liable for registering the transfer. See Section 8-404.

Definitional Cross References:

"Entitlement order". Section 8-102(a)(8).

"Financial asset". Section 8-102(a)(9).

"Indorsement". Section 8-102(a)(11).

"Instruction". Section 8-102(a)(12).

"Representative". Section 8-201(35).

"Securities account". Section 8-501.

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

"Security entitlement". Section 8-102(a)(17).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-108. Warranties in direct holding. — (1) A person who transfers a certificated security to a purchaser for value warrants to the purchaser, and an indorser, if the transfer is by indorsement, warrants to any subsequent purchaser, that:

(a) The certificate is genuine and has not been materially altered; (b) The transferor or indorser does not know of any fact that might impair the validity of the security; (c) There is no adverse claim to the security; (d) The transfer does not violate any restriction on transfer; (e) If the transfer is by indorsement, the indorsement is made by an appropriate person, or if the indorsement is by an agent, the agent has actual authority to act on behalf of the appropriate person; and (f) The transfer is otherwise effective and rightful.

(2) A person who originates an instruction for registration of transfer of an uncertificated security to a purchaser for value warrants to the purchaser that: (a) The instruction is made by an appropriate person, or if the instruction is by an agent, the agent has actual authority to act on behalf of the appropriate person; (b) The security is valid;

(c) There is no adverse claim to the security; and (d) At the time the instruction is presented to the issuer: (i) The purchaser will be entitled to the registration of transfer; (ii) The transfer will be registered by the issuer free from all liens, security interests, restrictions and claims other than those specified in the instruction; (iii) The transfer will not violate any restriction on transfer; and (iv) The requested transfer will otherwise be effective and rightful.

(3) A person who transfers an uncertificated security to a purchaser for value and does not originate an instruction in connection with the transfer warrants that: (a) The uncertificated security is valid; (b) There is no adverse claim to the security; (c) The transfer does not violate any restriction on transfer; and (d) The transfer is otherwise effective and rightful.

(4) A person who indorses a security certificate warrants to the issuer that: (a) There is no adverse claim to the security; and (b) The indorsement

is effective.

(5) A person who originates an instruction for registration of transfer of an uncertificated security warrants to the issuer that: (a) The instruction is effective; and

(b) At the time the instruction is presented to the issuer the purchaser will be entitled to the registration of transfer.

(6) A person who presents a certificated security for registration of transfer or for payment or exchange warrants to the issuer that the person is entitled to the registration, payment or exchange, but a purchaser for value and without notice of adverse claims to whom transfer is registered warrants only that the person has no knowledge of any unauthorized signature in a necessary indorsement.

(7) If a person acts as agent of another in delivering a certificated security to a purchaser, the identity of the principal was known to the person to whom the certificate was delivered, and the certificate delivered by the agent was received by the agent from the principal or received by the agent from another person at the direction of the principal, the person delivering the security certificate warrants only that the delivering person has authority to act for the principal and does not know of any adverse claim to the certificated security.

(8) A secured party who redelivers a security certificate received, or after payment and on order of the debtor delivers the security certificate to another person, makes only the warranties of an agent under subsection (7) of this section.

(9) Except as otherwise provided in subsection (7) of this section, a broker acting for a customer makes to the issuer and a purchaser the warranties provided in subsections (1) through (6) of this section. A broker that delivers a security certificate to its customer, or causes its customer to be registered as the owner of an uncertificated security, makes to the customer the warranties provided in subsection (1) or (2) of this section, and has the rights and privileges of a purchaser under this section. The warranties of and in favor of the broker acting as an agent are in addition to applicable warranties given by and in favor of the customer.

History.

I.C., § 28-8-108, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-108 was repealed. See Prior Laws, § 28-8-101.

CASE NOTES

Decisions Under Prior Law

Bona fide purchasers.

Notice.

Proximate cause of loss.

Reliance.

Warranties.

Bona Fide Purchasers.

Where a bank could not have known that a joint owner of stock claimed rights to the pledged collateral, because her signature was forged, by extending credit the bank became a bona fide purchaser of the pledged securities after receiving delivery of the shares pursuant to a pledge agreement. Ogilvie v. Idaho Bank & Trust Co., 99 Idaho 361, 582 P.2d 215 (1978).

Notice.

Since under former law notice to a transfer agent was notice to the issuer with respect to the functions performed by the agent, likewise notice to the issuer was notice to the agent precluding reliance by the issuer on guarantees to the agent. Flying Diamond Corp. v. Pennaluna & Co., 586 F.2d 707 (9th Cir. 1978).

Proximate Cause of Loss.

The proximate cause of an issuer's loss was not the conduct of the guarantors of its stock certificates, but rather was the issuer's own conduct of entrusting its transfer agent with blank certificates and subsequently

failing to take proper precautions after learning of the authorized actions. Flying Diamond Corp. v. Pennaluna & Co., 586 F.2d 707 (9th Cir. 1978).

Reliance.

When an issuer fails to inform its agent of crucial facts within the issuer's knowledge, it may not claim the agent's reliance as its own. Flying Diamond Corp. v. Pennaluna & Co., 586 F.2d 707 (9th Cir. 1978).

Warranties.

Where issuing company had reason to know that certificates, indorsement signatures thereon, and the guarantee of signatures were improper and where it failed to exercise due diligence in its issuing practices, the company had no right to rely on the warranties under this section. Flying Diamond Corp. v. Pennaluna & Co., 586 F.2d 707 (9th Cir. 1978).

Official Comment

1. Subsections (a), (b), and (c) deal with warranties by security transferors to purchasers. Subsections (d) and (e) deal with warranties by security transferors to issuers. Subsection (f) deals with presentment warranties.

2. Subsection (a) specifies the warranties made by a person who transfers a certificated security to a purchaser for value. Paragraphs (3), (4), and (5) make explicit several key points that are implicit in the general warranty of paragraph (6) that the transfer is effective and rightful. Subsection (b) sets forth the warranties made to a purchaser for value by one who originates an instruction. These warranties are quite similar to those made by one transferring a certificated security, subsection (a), the principal difference being the absolute warranty of validity. If upon receipt of the instruction the issuer should dispute the validity of the security, the burden of proving validity is upon the transferor. Subsection (c) provides for the limited circumstances in which an uncertificated security could be transferred without an instruction, see Section 8-301(b)(2). Subsections (d) and (e) give the issuer the benefit of the warranties of an indorser or originator on those matters not within the issuer's knowledge.

3. Subsection (f) limits the warranties made by a purchaser for value without notice whose presentation of a security certificate is defective in

some way but to whom the issuer does register transfer. The effect is to deny the issuer a remedy against such a person unless at the time of presentment the person had knowledge of an unauthorized signature in a necessary indorsement. The issuer can protect itself by refusing to make the transfer or, if it registers the transfer before it discovers the defect, by pursuing its remedy against a signature guarantor.

4. Subsection (g) eliminates all substantive warranties in the relatively unusual case of a delivery of certificated security by an agent of a disclosed principal where the agent delivers the exact certificate that it received from or for the principal. Subsection (h) limits the warranties given by a secured party who redelivers a certificate. Subsection (i) specifies the warranties of brokers in the more common scenarios.

5. Under Section 1-102(3) the warranty provisions apply "unless otherwise agreed" and the parties may enter into express agreements to allocate the risks of possible defects. Usual estoppel principles apply with respect to transfers of both certificated and uncertificated securities whenever the purchaser has knowledge of the defect, and these warranties will not be breached in such a case.

Definitional Cross References: "Adverse claim". Section 8-102(a)(1).

"Appropriate person". Section 8-107.

"Broker". Section 8-102(a)(3).

"Certificated security". Section 8-102(a)(4).

"Indorsement". Section 8-102(a)(11).

"Instruction". Section 8-102(a)(12).

"Issuer". Section 8-201.

"Person". Section 1-201(30).

"Purchaser". Sections 1-201(30) & 8-116.

"Secured party". Section 9-105(1)(m).

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

"Uncertificated security". Section 8-102(a)(18).

“Value”. Sections 1-201(44) [now 1-204] & 8-116.

§ 28-8-109. Warranties in indirect holding. — (1) A person who originates an entitlement order to a securities intermediary warrants to the securities intermediary that:

(a) The entitlement order is made by an appropriate person, or if the entitlement order is by an agent, the agent has actual authority to act on behalf of the appropriate person; and (b) There is no adverse claim to the security entitlement.

(2) A person who delivers a security certificate to a securities intermediary for credit to a securities account or originates an instruction with respect to an uncertificated security directing that the uncertificated security be credited to a securities account makes to the securities intermediary the warranties specified in section 28-8-108(1) or (2)[, Idaho Code].

(3) If a securities intermediary delivers a security certificate to its entitlement holder or causes its entitlement holder to be registered as the owner of an uncertificated security, the securities intermediary makes to the entitlement holder the warranties specified in section 28-8-108(1) or (2)[, Idaho Code].

History.

I.C., § 28-8-109, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions at the end of subsections (2) and (3) were added by the compiler to conform to the statutory citation style.

Official Comment

1. Subsection (a) provides that a person who originates an entitlement order warrants to the securities intermediary that the order is authorized, and warrants the absence of adverse claims. Subsection (b) specifies the warranties that are given when a person who holds securities directly has

the holding converted into indirect form. A person who delivers a certificate to a securities intermediary or originates an instruction for an uncertificated security gives to the securities intermediary the transfer warranties under Section 8-108. If the securities intermediary in turn delivers the certificate to a higher level securities intermediary, it gives the same warranties.

2. Subsection (c) states the warranties that a securities intermediary gives when a customer who has been holding securities in an account with the securities intermediary requests that certificates be delivered or that uncertificated securities be registered in the customer's name. The warranties are the same as those that brokers make with respect to securities that the brokers sell to or buy on behalf of the customers. See Section 8-108(i).

3. As with the Section 8-108 warranties, the warranties specified in this section may be modified by agreement under Section 1-102(3).

Definitional Cross References: "Adverse claim". Section 8-102(a)(1).

"Appropriate person". Section 8-107.

"Entitlement holder". Section 8-102(a)(7).

"Entitlement order". Section 8-102(a)(8).

"Instruction". Section 8-102(a)(12).

"Person". Section 1-201(30).

"Securities account". Section 8-501.

"Securities intermediary". Section 8-102(a)(14).

"Security certificate". Section 8-102(a)(16).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-110. Applicability and choice of law. — (1) The local law of the issuer's jurisdiction, as specified in subsection (4) of this section, governs:

(a) The validity of a security;

(b) The rights and duties of the issuer with respect to registration of transfer;

(c) The effectiveness of registration of transfer by the issuer;

(d) Whether the issuer owes any duties to an adverse claimant to a security; and

(e) Whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

(2) The local law of the securities intermediary's jurisdiction, as specified in subsection (5) of this section, governs:

(a) Acquisition of a security entitlement from the securities intermediary;

(b) The rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;

(c) Whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and

(d) Whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.

(3) The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.

(4) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized

under the law of this state may specify the law of another jurisdiction as the law governing the matters specified in subsections (1)(b) through (1)(e) of this section.

(5) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(a) If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this part, this chapter, or this act, that jurisdiction is the securities intermediary's jurisdiction.

(b) If paragraph (a) of this subsection does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(c) If neither paragraph (a) nor paragraph (b) of this section applies and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(d) If none of the preceding paragraphs apply, the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located.

(e) If none of the preceding paragraphs apply, the securities intermediary's jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.

(6) A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other recordkeeping concerning the account.

History.

I.C., § 28-8-110, as added by 1995, ch. 272, § 2, p. 873; am. 2001, ch. 208, § 16, p. 704.

STATUTORY NOTES

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

RESEARCH REFERENCES

Idaho Law Review. — Choice of Law in Idaho: A Survey and Critique of Idaho Cases, Andrew S. Jorgensen. 49 Idaho L. Rev. 547 (2013).

Official Comment

1. This section deals with applicability and choice of law issues concerning Article 8. The distinction between the direct and indirect holding systems plays a significant role in determining the governing law. An investor in the direct holding system is registered on the books of the issuer and/or has possession of a security certificate. Accordingly, the jurisdiction of incorporation of the issuer or location of the certificate determines the applicable law. By contrast, an investor in the indirect holding system has a security entitlement, which is a bundle of rights against the securities intermediary with respect to a security, rather than a direct interest in the underlying security. Accordingly, in the rules for the indirect holding system, the jurisdiction of incorporation of the issuer of the underlying security or the location of any certificates that might be held by the intermediary or a higher tier intermediary, do not determine the applicable law.

The phrase "local law" refers to the law of a jurisdiction other than its conflict of laws rules. See Restatement (Second) of Conflict of Laws § 4.

2. Subsection (a) provides that the law of an issuer's jurisdiction governs certain issues where the substantive rules of Article 8 determine the issuer's rights and duties. Paragraph (1) of subsection (a) provides that the law of the issuer's jurisdiction governs the validity of the security. This ensures that a single body of law will govern the questions addressed in Part 2 of

Article 8, concerning the circumstances in which an issuer can and cannot assert invalidity as a defense against purchasers. Similarly, paragraphs (2), (3), and (4) of subsection (a) ensure that the issuer will be able to look to a single body of law on the questions addressed in Part 4 of Article 8, concerning the issuer's duties and liabilities with respect to registration of transfer.

Paragraph (5) of subsection (a) applies the law of an issuer's jurisdiction to the question whether an adverse claim can be asserted against a purchaser to whom transfer has been registered, or who has obtained control over an uncertificated security. Although this issue deals with the rights of persons other than the issuer, the law of the issuer's jurisdiction applies because the purchasers to whom the provision applies are those whose protection against adverse claims depends on the fact that their interests have been recorded on the books of the issuer.

The principal policy reflected in the choice of law rules in subsection (a) is that an issuer and others should be able to look to a single body of law on the matters specified in subsection (a), rather than having to look to the law of all of the different jurisdictions in which security holders may reside. The choice of law policies reflected in this subsection do not require that the body of law governing all of the matters specified in subsection (a) be that of the jurisdiction in which the issuer is incorporated. Thus, subsection (d) provides that the term "issuer's jurisdiction" means the jurisdiction in which the issuer is organized, or, if permitted by that law, the law of another jurisdiction selected by the issuer. Subsection (d) also provides that issuers organized under the law of a State which adopts this Article may make such a selection, except as to the validity issue specified in paragraph (1). The question whether an issuer can assert the defense of invalidity may implicate significant policies of the issuer's jurisdiction of incorporation. See, e.g., Section 8-202 and Comments thereto.

Although subsection (a) provides that the issuer's rights and duties concerning registration of transfer are governed by the law of the issuer's jurisdiction, other matters related to registration of transfer, such as appointment of a guardian for a registered owner or the existence of agency relationships, might be governed by another jurisdiction's law. Neither this section nor Section 1-105 deals with what law governs the appointment of

the administrator or executor; that question is determined under generally applicable choice of law rules.

3. Subsection (b) provides that the law of the securities intermediary's jurisdiction governs the issues concerning the indirect holding system that are dealt with in Article 8. Paragraphs (1) and (2) cover the matters dealt with in the Article 8 rules defining the concept of security entitlement and specifying the duties of securities intermediaries. Paragraph (3) provides that the law of the security intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (4) provides that the law of the security intermediary's jurisdiction determines whether adverse claims can be asserted against entitlement holders and others.

Subsection (e) determines what is a "securities intermediary's jurisdiction." The policy of subsection (b) is to ensure that a securities intermediary and all of its entitlement holders can look to a single, readily-identifiable body of law to determine their rights and duties. Accordingly, subsection (e) sets out a sequential series of tests to facilitate identification of the body of law. Paragraph (1) of subsection (e) permits specification of the securities intermediary's jurisdiction by agreement. In the absence of such a specification, the law chosen by the parties to govern the securities account determines the securities intermediary's jurisdiction. See paragraph (2). Because the policy of this section is to enable parties to determine, in advance and with certainty, what law will apply to transactions governed by this Article, the validation of the parties' selection of governing law by agreement is not conditioned upon a determination that the jurisdiction whose law is chosen bear a "reasonable relation" to the transaction. See Section 4A-507; compare Section 1-105(1). That is also true with respect to the similar provisions in subsection (d) of this section and in Section 9-305. The remaining paragraphs in subsection (e) contain additional default rules for determining the securities intermediary's jurisdiction.

Subsection (f) makes explicit a point that is implicit in the Article 8 description of a security entitlement as a bundle of rights against the intermediary with respect to a security or other financial asset, rather than as a direct interest in the underlying security or other financial asset. The governing law for relationships in the indirect holding system is not determined by such matters as the jurisdiction of incorporation of the issuer

of the securities held through the intermediary, or the location of any physical certificates held by the intermediary or a higher tier intermediary.

4. Subsection (c) provides a choice of law rule for adverse claim issues that may arise in connection with delivery of security certificates in the direct holding system. It applies the law of the place of delivery. If a certificated security issued by an Idaho corporation is sold, and the sale is settled by physical delivery of the certificate from Seller to Buyer in New York, under subsection (c), New York law determines whether Buyer takes free from adverse claims. The domicile of Seller, Buyer, and any adverse claimant is irrelevant.

5. The following examples illustrate how a court in a jurisdiction which has enacted this section would determine the governing law:

Example 1. John Doe, a resident of Kansas, maintains a securities account with Able & Co. Able is incorporated in Delaware. Its chief executive offices are located in Illinois. The office where Doe transacts business with Able is located in Missouri. The agreement between Doe and Able specifies that Illinois law is the securities intermediary's (Able's) jurisdiction. Through the account, Doe holds securities of a Colorado corporation, which Able holds through Clearing Corporation. The rules of Clearing Corporation provide that the rights and duties of Clearing Corporation and its participants are governed by New York law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Clearing Corporation is governed by Colorado law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between the Clearing Corporation and Able is governed by New York law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

Example 2. Same facts as to Doe and Able as in Example 1. Through the account, Doe holds securities of a Senegalese corporation, which Able holds through Clearing Corporation. Clearing Corporation's operations are located in Belgium, and its rules and agreements with its participants provide that they are governed by Belgian law. Clearing Corporation holds the securities through a custodial account at the Paris branch office of Global Bank, which is organized under English law. The agreement between Clearing Corporation and Global Bank provides that it is governed

by French law. Subsection (a) specifies that a controversy concerning the rights and duties as between the issuer and Global Bank is governed by Senegalese law. Subsections (b) and (e) specify that a controversy concerning the rights and duties as between Global Bank and Clearing Corporation is governed by French law, that a controversy concerning the rights and duties as between Clearing Corporation and Able is governed by Belgian law, and that a controversy concerning the rights and duties as between Able and Doe is governed by Illinois law.

6. To the extent that this section does not specify the governing law, general choice of law rules apply. For example, suppose that in either of the examples in the preceding Comment, Doe enters into an agreement with Roe, also a resident of Kansas, in which Doe agrees to transfer all of his interests in the securities held through Able to Roe. Article 8 does not deal with whether such an agreement is enforceable or whether it gives Roe some interest in Doe's security entitlement. This section specifies what jurisdiction's law governs the issues that are dealt with in Article 8. Article 8, however, does specify that securities intermediaries have only limited duties with respect to adverse claims. See Section 8-115. Subsection (b)(3) of this section provides that Illinois law governs whether Able owes any duties to an adverse claimant. Thus, if Illinois has adopted Revised Article 8, Section 8-115 as enacted in Illinois determines whether Roe has any rights against Able.

7. The choice of law provisions concerning security interests in securities and security entitlements are set out in Section 9-305.

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1).

"Agreement". Section 1-201(3).

"Certificated security". Section 8-102(a)(4).

"Entitlement holder". Section 8-102(a)(7).

"Financial asset". Section 8-102(a)(9).

"Issuer". Section 8-201.

"Person". Section 1-201(30).

"Purchase". Section 1-201(32).

"Securities intermediary". Section 8-102(a)(14).

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

"Security entitlement". Section 8-102(a)(17).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-111. Clearing corporation rules. — A rule adopted by a clearing corporation governing rights and obligations among the clearing corporation and its participants in the clearing corporation is effective even if the rule conflicts with this act and affects another party who does not consent to the rule.

History.

I.C., § 28-8-111, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Compiler's Notes.

The term "this act" in this section refers to S.L. 1995, ch. 272, which revised Article (Chapter) 8 of the Uniform Commercial Code and amended many other sections of the Idaho Code in conformity with that revision.

Official Comment 1. The experience of the past few decades shows that securities holding and settlement practices may develop rapidly, and in unforeseeable directions. Accordingly, it is desirable that the rules of Article 8 be adaptable both to ensure that commercial law can conform to changing practices and to ensure that commercial law does not operate as an obstacle to developments in securities practice. Even if practices were unchanging, it would not be possible in a general statute to specify in detail the rules needed to provide certainty in the operations of the clearance and settlement system.

The provisions of this Article and Article 1 on the effect of agreements provide considerable flexibility in the specification of the details of the rights and obligations of participants in the securities holding system by agreement. See Sections 8-504 through 8-509, and Section 1-102(3) and (4). Given the magnitude of the exposures involved in securities transactions, however, it may not be possible for the parties in developing practices to rely solely on private agreements, particularly with respect to matters that might affect others, such as creditors. For example, in order to be fully effective, rules of clearing corporations on the finality or

reversibility of securities settlements must not only bind the participants in the clearing corporation but also be effective against their creditors. Section 8-111 provides that clearing corporation rules are effective even if they indirectly affect third parties, such as creditors of a participant. This provision does not, however, permit rules to be adopted that would govern the rights and obligations of third parties other than as a consequence of rules that specify the rights and obligations of the clearing corporation and its participants.

2. The definition of clearing corporation in Section 8-102 covers only federal reserve banks, entities registered as clearing agencies under the federal securities laws, and others subject to comparable regulation. The rules of registered clearing agencies are subject to regulatory oversight under the federal securities laws.

Definitional Cross References: "Clearing corporation". Section 8-102(a)(5).

§ 28-8-112. Creditor's legal process. — (1) The interest of a debtor in a certificated security may be reached by a creditor only by actual seizure of the security certificate by the officer making the attachment or levy, except as otherwise provided in subsection (4) of this section. However, a certificated security for which the certificate has been surrendered to the issuer may be reached by a creditor by legal process upon the issuer.

(2) The interest of a debtor in an uncertificated security may be reached by a creditor only by legal process upon the issuer at its chief executive office in the United States, except as otherwise provided in subsection (4) of this section.

(3) The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with whom the debtor's securities account is maintained, except as otherwise provided in subsection (4) of this section.

(4) The interest of a debtor in a certificated security for which the certificate is in the possession of a secured party, or in an uncertificated security registered in the name of a secured party, or a security entitlement maintained in the name of a secured party, may be reached by a creditor by legal process upon the secured party.

(5) A creditor whose debtor is the owner of a certificated security, uncertificated security or security entitlement is entitled to aid from a court of competent jurisdiction, by injunction or otherwise, in reaching the certificated security, uncertificated security, or security entitlement or in satisfying the claim by means allowed at law or in equity in regard to property that cannot readily be reached by other legal process.

History.

I.C., § 28-8-112, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. In dealing with certificated securities the instrument itself is the vital thing, and therefore a valid levy cannot be made unless all possibility of the

certificate's wrongfully finding its way into a transferee's hands has been removed. This can be accomplished only when the certificate is in the possession of a public officer, the issuer, or an independent third party. A debtor who has been enjoined can still transfer the security in contempt of court. See *Overlock v. Jerome-Portland Copper Mining Co*., 29 Ariz. 560, 243 P. 400 (1926). Therefore, although injunctive relief is provided in subsection (e) so that creditors may use this method to gain control of the certificated security, the security certificate itself must be reached to constitute a proper levy whenever the debtor has possession.

2. Subsection (b) provides that when the security is uncertificated and registered in the debtor's name, the debtor's interest can be reached only by legal process upon the issuer. The most logical place to serve the issuer would be the place where the transfer records are maintained, but that location might be difficult to identify, especially when the separate elements of a computer network might be situated in different places. The chief executive office is selected as the appropriate place by analogy to Section 9-103(3)(d). See Comment 5(c) to that section. This section indicates only how attachment is to be made, not when it is legally justified. For that reason there is no conflict between this section and *Shaffer v. Heitner*, 433 U.S. 186 (1977).

3. Subsection (c) provides that a security entitlement can be reached only by legal process upon the debtor's security intermediary. Process is effective only if directed to the debtor's own security intermediary. If Debtor holds securities through Broker, and Broker in turn holds through Clearing Corporation, Debtor's property interest is a security entitlement against Broker. Accordingly, Debtor's creditor cannot reach Debtor's interest by legal process directed to the Clearing Corporation. See also Section 8-115.

4. Subsection (d) provides that when a certificated security, an uncertificated security, or a security entitlement is controlled by a secured party, the debtor's interest can be reached by legal process upon the secured party. This section does not attempt to provide for rights as between the creditor and the secured party, as, for example, whether or when the secured party must liquidate the security.

Definitional Cross References: "Certificated security". Section 8-102(a)(4).

"Issuer". Section 8-201.

"Secured party". Section 9-105(1)(m).

"Securities intermediary". Section 8-102(a)(14).

"Security certificate". Section 8-102(a)(16).

"Security entitlement". Section 8-102(a)(17).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-113. Statute of frauds inapplicable. — A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one (1) year of its making.

History.

I.C., § 28-8-113, as added by 1995, ch. 272, § 2, p. 873.

Official Comment This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in Section 8-319 (1978). With the increasing use of electronic means of communication, the statute of frauds is unsuited to the realities of the securities business. For securities transactions, whatever benefits a statute of frauds may play in filtering out fraudulent claims are outweighed by the obstacles it places in the development of modern commercial practices in the securities business.

Definitional Cross References: "Action". Section 1-201(1).

"Contract". Section 1-201(11).

"Writing". Section 1-201(46).

§ 28-8-114. Evidentiary rules concerning certificated securities. — The following rules apply in an action on a certificated security against the issuer:

(1) Unless specifically denied in the pleadings, each signature on a security certificate or in a necessary indorsement is admitted.

(2) If the effectiveness of a signature is put in issue, the burden of establishing effectiveness is on the party claiming under the signature, but the signature is presumed to be genuine or authorized.

(3) If signatures on a security certificate are admitted or established, production of the certificate entitles a holder to recover on it unless the defendant establishes a defense or a defect going to the validity of the security.

(4) If it is shown that a defense or defect exists, the plaintiff has the burden of establishing that the plaintiff or some person under whom the plaintiff claims is a person against whom the defense or defect cannot be asserted.

History.

I.C., § 28-8-114, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

This section adapts the rules of negotiable instruments law concerning procedure in actions on instruments, see Section 3-308, to actions on certificated securities governed by this Article. An “action on a security” includes any action or proceeding brought against the issuer to enforce a right or interest that is part of the security, such as an action to collect principal or interest or a dividend, or to establish a right to vote or to receive a new security under an exchange offer or plan of reorganization. This section applies only to certificated securities; actions on uncertificated securities are governed by general evidentiary principles.

Definitional Cross References: “Action”. Section 1-201(1).

"Burden of establishing". Section 1-201(8).

"Certificated security". Section 8-102(a)(4).

"Indorsement". Section 8-102(a)(11).

"Issuer". Section 8-201.

"Presumed". Section 1-201(31).

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

§ 28-8-115. Securities intermediary and others not liable to adverse claimant. — A securities intermediary that has transferred a financial asset pursuant to an effective entitlement order, or a broker or other agent or bailee that has dealt with a financial asset at the direction of its customer or principal, is not liable to a person having an adverse claim to the financial asset, unless the securities intermediary, or broker or other agent or bailee:

(1) Took the action after it had been served with an injunction, restraining order, or other legal process enjoining it from doing so, issued by a court of competent jurisdiction, and had a reasonable opportunity to act on the injunction, restraining order or other legal process; or

(2) Acted in collusion with the wrongdoer in violating the rights of the adverse claimant; or

(3) In the case of a security certificate that has been stolen, acted with notice of the adverse claim.

History.

I.C., § 28-8-115, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. Other provisions of Article 8 protect certain purchasers against adverse claims, both for the direct holding system and the indirect holding system. See Sections 8-303 and 8-502. This section deals with the related question of the possible liability of a person who acted as the "conduit" for a securities transaction. It covers both securities intermediaries — the "conduits" in the indirect holding system — and brokers or other agents or bailees — the "conduits" in the direct holding system. The following examples illustrate its operation:

Example 1. John Doe is a customer of the brokerage firm of Able & Co. Doe delivers to Able a certificate for 100 shares of XYZ Co. common stock, registered in Doe's name and properly indorsed, and asks the firm to sell it for him. Able does so. Later, John Doe's spouse Mary Doe brings an action

against Able asserting that Able's action was wrongful against her because the XYZ Co. stock was marital property in which she had an interest, and John Doe was acting wrongfully against her in transferring the securities.

Example 2. Mary Roe is a customer of the brokerage firm of Baker & Co. and holds her securities through a securities account with Baker. Roe instructs Baker to sell 100 shares of XYZ Co. common stock that she carried in her account. Baker does so. Later, Mary Roe's spouse John Roe brings an action against Baker asserting that Baker's action was wrongful against him because the XYZ Co. stock was marital property in which he had an interest, and Mary Roe was acting wrongfully against him in transferring the securities.

Under common law conversion principles, Mary Doe might be able to assert that Able & Co. is liable to her in Example 1 for exercising dominion over property inconsistent with her rights in it. On that or some similar theory John Roe might assert that Baker is liable to him in Example 2. Section 8-115 protects both Able and Baker from liability.

2. The policy of this section is similar to that of many other rules of law that protect agents and bailees from liability as innocent converters. If a thief steals property and ships it by mail, express service, or carrier, to another person, the recipient of the property does not obtain good title, even though the recipient may have given value to the thief and had no notice or knowledge that the property was stolen. Accordingly, the true owner can recover the property from the recipient or obtain damages in a conversion or similar action. An action against the postal service, express company, or carrier presents entirely different policy considerations. Accordingly, general tort law protects agents or bailees who act on the instructions of their principals or bailors. See Restatement (Second) of Torts § 235. See also UCC Section 7-404.

3. Except as provided in paragraph 3, this section applies even though the securities intermediary, or the broker or other agent or bailee, had notice or knowledge that another person asserts a claim to the securities. Consider the following examples:

Example 3. Same facts as in Example 1, except that before John Doe brought the XYZ Co. security certificate to Able for sale, Mary Doe

telephoned or wrote to the firm asserting that she had an interest in all of John Doe's securities and demanding that they not trade for him.

Example 4. Same facts as in Example 2, except that before Mary Roe gave an entitlement order to Baker to sell the XYZ Co. securities from her account, John Roe telephoned or wrote to the firm asserting that he had an interest in all of Mary Roe's securities and demanding that they not trade for her.

Section 8-115 protects Able and Baker from liability. The protections of Section 8-115 do not depend on the presence or absence of notice of adverse claims. It is essential to the securities settlement system that brokers and securities intermediaries be able to act promptly on the directions of their customers. Even though a firm has notice that someone asserts a claim to a customer's securities or security entitlements, the firm should not be placed in the position of having to make a legal judgment about the validity of the claim at the risk of liability either to its customer or to the third party for guessing wrong. Under this section, the broker or securities intermediary is privileged to act on the instructions of its customer or entitlement holder, unless it has been served with a restraining order or other legal process enjoining it from doing so. This is already the law in many jurisdictions. For example a section of the New York Banking Law provides that banks need not recognize any adverse claim to funds or securities on deposit with them unless they have been served with legal process. N.Y. Banking Law § 134. Other sections of the UCC embody a similar policy. See Sections 3-602, 5-114(2)(b).

Paragraph (1) of this section refers only to a court order enjoining the securities intermediary or the broker or other agent or bailee from acting at the instructions of the customer. It does not apply to cases where the adverse claimant tells the intermediary or broker that the customer has been enjoined, or shows the intermediary or broker a copy of a court order binding the customer.

Paragraph (3) takes a different approach in one limited class of cases, those where a customer sells stolen certificated securities through a securities firm. Here the policies that lead to protection of securities firms against assertions of other sorts of claims must be weighed against the desirability of having securities firms guard against the disposition of stolen

securities. Accordingly, paragraph (3) denies protection to a broker, custodian, or other agent or bailee who receives a stolen security certificate from its customer, if the broker, custodian, or other agent or bailee had notice of adverse claims. The circumstances that give notice of adverse claims are specified in Section 8-105. The result is that brokers, custodians, and other agents and bailees face the same liability for selling stolen certificated securities that purchasers face for buying them.

4. As applied to securities intermediaries, this section embodies one of the fundamental principles of the Article 8 indirect holding system rules — that a securities intermediary owes duties only to its own entitlement holders. The following examples illustrate the operation of this section in the multi-tiered indirect holding system:

Example 5. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able acquired the XYZ shares from another firm, Baker & Co., in a transaction that Baker contends was tainted by fraud, giving Baker a right to rescind the transaction and recover the XYZ shares from Able. Baker sends notice to Clearing Corporation stating that Baker has a claim to the 50,000 shares of XYZ Co. in Able's account. Able then initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. Under Section 8-115, Clearing Corporation is privileged to comply with Able's entitlement order, without fear of liability to Baker. This is so even though Clearing Corporation has notice of Baker's claim, unless Baker obtains a court order enjoining Clearing Corporation from acting on Able's entitlement order.

Example 6. Able & Co., a broker-dealer, holds 50,000 shares of XYZ Co. stock in its account at Clearing Corporation. Able initiates an entitlement order directing Clearing Corporation to transfer the 50,000 shares of XYZ Co. to another firm in settlement of a trade. That trade was made by Able for its own account, and the proceeds were devoted to its own use. Able becomes insolvent, and it is discovered that Able has a shortfall in the shares of XYZ Co. stock that it should have been carrying for its customers. Able's customers bring an action against Clearing Corporation asserting that Clearing Corporation acted wrongfully in transferring the XYZ shares on Able's order because those were shares that should have been held by Able for its customers. Under Section 8-115, Clearing Corporation is not

liable to Able's customers, because Clearing Corporation acted on an effective entitlement order of its own entitlement holder, Able. Clearing Corporation's protection against liability does not depend on the presence or absence of notice or knowledge of the claim by Clearing Corporation.

5. If the conduct of a securities intermediary or a broker or other agent or bailee rises to a level of complicity in the wrongdoing of its customer or principal, the policies that favor protection against liability do not apply. Accordingly, paragraph (2) provides that the protections of this section do not apply if the securities intermediary or broker or other agent or bailee acted in collusion with the customer or principal in violating the rights of another person. The collusion test is intended to adopt a standard akin to the tort rules that determines whether a person is liable as an aider or abettor for the tortious conduct of a third party. See Restatement (Second) of Torts § 876.

Knowledge that the action of the customer is wrongful is a necessary but not sufficient condition of the collusion test. The aspect of the role of securities intermediaries and brokers that Article 8 deals with is the clerical or ministerial role of implementing and recording the securities transactions that their customers conduct. Faithful performance of this role consists of following the instructions of the customer. It is not the role of the record-keeper to police whether the transactions recorded are appropriate, so mere awareness that the customer may be acting wrongfully does not itself constitute collusion. That, of course, does not insulate an intermediary or broker from responsibility in egregious cases where its action goes beyond the ordinary standards of the business of implementing and recording transactions, and reaches a level of affirmative misconduct in assisting the customer in the commission of a wrong.

Definitional Cross References:

"Broker". Section 8-102(a)(3).

"Effective". Section 8-107.

"Entitlement order". Section 8-102(a)(8).

"Financial asset". Section 8-102(a)(9).

"Securities intermediary". Section 8-102(a)(14).

“Security certificate”. Section 8-102(a)(16).

§ 28-8-116. Securities intermediary as purchaser for value. — A securities intermediary that receives a financial asset and establishes a security entitlement to the financial asset in favor of an entitlement holder is a purchaser for value of the financial asset. A securities intermediary that acquires a security entitlement to a financial asset from another securities intermediary acquires the security entitlement for value if the securities intermediary acquiring the security entitlement establishes a security entitlement to the financial asset in favor of an entitlement holder.

History.

I.C., § 28-8-116, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. This section is intended to make explicit two points that, while implicit in other provisions, are of sufficient importance to the operation of the indirect holding system that they warrant explicit statement. First, it makes clear that a securities intermediary that receives a financial asset and establishes a security entitlement in respect thereof in favor of an entitlement holder is a "purchaser" of the financial asset that the securities intermediary received. Second, it makes clear that by establishing a security entitlement in favor of an entitlement holder a securities intermediary gives value for any corresponding financial asset that the securities intermediary receives or acquires from another party, whether the intermediary holds directly or indirectly.

In many cases a securities intermediary that receives a financial asset will also be transferring value to the person from whom the financial asset was received. That, however, is not always the case. Payment may occur through a different system than settlement of the securities side of the transaction, or the securities might be transferred without a corresponding payment, as when a person moves an account from one securities intermediary to another. Even though the securities intermediary does not give value to the transferor, it does give value by incurring obligations to its own entitlement holder. Although the general definition of value in Section

1-201(44)(d) [now 1-204] should be interpreted to cover the point, this section is included to make this point explicit.

2. The following examples illustrate the effect of this section: Example 1. Buyer buys 1000 shares of XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. In settlement of the trade, the selling broker delivers to Able a security certificate in street name, indorsed in blank, for 1000 shares XYZ Co. stock, which Able holds in its vault. Able credits Buyer's account for securities in that amount. Section 8-116 specifies that Able is a purchaser of the XYZ Co. stock certificate, and gave value for it. Thus, Able can obtain the benefit of Section 8-303, which protects purchasers for value, if it satisfies the other requirements of that section.

Example 2. Buyer buys 1000 shares XYZ Co. common stock through Buyer's broker Able & Co. to be held in Buyer's securities account. The trade is settled by crediting 1000 shares XYZ Co. stock to Able's account at Clearing Corporation. Able credits Buyer's account for securities in that amount. When Clearing Corporation credits Able's account, Able acquires a security entitlement under Section 8-501. Section 8-116 specifies that Able acquired this security entitlement for value. Thus, Able can obtain the benefit of Section 8-502, which protects persons who acquire security entitlements for value, if it satisfies the other requirements of that section.

Example 3. Thief steals a certificated bearer bond from Owner. Thief sends the certificate to his broker Able & Co. to be held in his securities account, and Able credits Thief's account for the bond. Section 8-116 specifies that Able is a purchaser of the bond and gave value for it. Thus, Able can obtain the benefit of Section 8-303, which protects purchasers for value, if it satisfies the other requirements of that section.

Definitional Cross References: "Financial asset". Section 8-102(a)(9).

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

"Entitlement holder". Section 8-102(a)(7).

§ 28-8-117. Savings clause. — (1) This act does not affect an action or proceeding commenced before this act takes effect.

(2) If a security interest in a security is perfected at the date this act takes effect, and the action by which the security interest was perfected would suffice to perfect a security interest under this act, no further action is required to continue perfection. If a security interest in a security is perfected at the date this act takes effect but the action by which the security interest was perfected would not suffice to perfect a security interest under this act, the security interest remains perfected for a period of four (4) months after the effective date and continues perfected thereafter if appropriate action to perfect under this act is taken within that period. If a security interest is perfected at the date this act takes effect and the security interest can be perfected by filing under this act, a financing statement signed by the secured party instead of the debtor may be filed within that period to continue perfection or thereafter to perfect.

History.

I.C., § 28-8-117, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Compiler's Notes.

The term "this act" in this section refers to S.L. 1995, ch. 272, which revised Article (Chapter) 8 of the Uniform Commercial Code and amended many other sections of the Idaho Code in conformity with that revision.

This section is designated as § 8-603 in the Uniform Code.

Official Comment

The revision of Article 8 should present few significant transition problems. Although the revision involves significant changes in terminology and analysis, the substantive rules are, in large measure, based upon the current practices and are consistent with results that could be reached, albeit at times with some struggle, by proper interpretation of the

rules of present law. Thus, the new rules can be applied, without significant dislocations, to transactions and events that occurred prior to enactment.

The enacting provisions should not, whether by applicability, transition, or savings clause language, attempt to provide that old Article 8 continues to apply to "transactions," "events," "rights," "duties," "liabilities," or the like that occurred or accrued before the effective date and that new Article 8 applies to those that occur or accrue after the effective date. The reason for revising Article 8 and corresponding provisions of Article 9 is the concern that the provisions of old Article 8 could be interpreted or misinterpreted to yield results that impede the safe and efficient operation of the national system for the clearance and settlement of securities transactions. Accordingly, it is not the case that any effort should be made to preserve the applicability of old Article 8 to transactions and events that occurred before the effective date.

Only two circumstances seem to warrant continued application of rules of old Article 8. First, to avoid disruption in the conduct of litigation, it may make sense to provide for continued application of the old Article 8 rules to lawsuits pending before the effective date. Second, there are some limited circumstances in which prior law permitted perfection of security interests by methods that are not provided for in the revised version. Section 8-313(1)(h) (1978) permitted perfection of security interests in securities held through intermediaries by notice to the intermediary. Under Revised Articles 8 and 9, security interests can be perfected in such cases by control, which requires the agreement of the intermediary, or by filing. It is likely that secured parties who relied strongly on such collateral under prior law did not simply send notices but obtained agreements from the intermediaries that would suffice for control under the new rules. However, it seems appropriate to include a provision that gives a secured creditor some opportunity after the effective date to perfect in this or any other case in which there is doubt whether the method of perfection used under prior law would be sufficient under the new version.

Part 2
Issue and Issuer

Idaho Code § 28-8-201

§ 28-8-201. Issuer. — (1) With respect to an obligation on or a defense to a security, an "issuer" includes a person that:

(a) Places or authorizes the placing of its name on a security certificate, other than as authenticating trustee, registrar, transfer agent, or the like, to evidence a share, participation or other interest in its property or in an enterprise, or to evidence its duty to perform an obligation represented by the certificate; (b) Creates a share, participation or other interest in its property or in an enterprise, or undertakes an obligation, that is an uncertificated security; (c) Directly or indirectly creates a fractional interest in its rights or property, if the fractional interest is represented by a security certificate; or (d) Becomes responsible for, or in place of, another person described as an issuer in this section.

(2) With respect to an obligation on or defense to a security, a guarantor is an issuer to the extent of its guaranty, whether or not its obligation is noted on a security certificate.

(3) With respect to a registration of a transfer, issuer means a person on whose behalf transfer books are maintained.

History.

I.C., § 28-8-201, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-201 was repealed. See Prior Laws, § 28-1-101.

Official Comment

1. The definition of "issuer" in this section functions primarily to describe the persons whose defenses may be cut off under the rules in Part

2. In large measure it simply tracks the language of the definition of security in Section 8-102(a)(15).

2. Subsection (b) distinguishes the obligations of a guarantor as issuer from those of the principal obligor. However, it does not exempt the guarantor from the impact of subsection (d) of Section 8-202. Whether or not the obligation of the guarantor is noted on the security is immaterial. Typically, guarantors are parent corporations, or stand in some similar relationship to the principal obligor. If that relationship existed at the time the security was originally issued the guaranty would probably have been noted on the security. However, if the relationship arose afterward, e.g., through a purchase of stock or properties, or through merger or consolidation, probably the notation would not have been made. Nonetheless, the holder of the security is entitled to the benefit of the obligation of the guarantor.

3. Subsection (c) narrows the definition of "issuer" for purposes of Part 4 of this Article (registration of transfer). It is supplemented by Section 8-407.

Definitional Cross References: "Person". Section 1-201(30).

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-202. Issuer's responsibility and defenses and notice of defect or defense. — (1) Even against a purchaser for value and without notice, the terms of a certificated security include terms stated on the certificate and terms made part of the security by reference on the certificate to another instrument, indenture or document or to a constitution, statute, ordinance, rule, regulation, order, or the like, to the extent the terms referred to do not conflict with terms stated on the certificate. A reference under this subsection does not of itself charge a purchaser for value with notice of a defect going to the validity of the security, even if the certificate expressly states that a person accepting it admits notice. The terms of an uncertificated security include those stated in any instrument, indenture, or document or in a constitution, statute, ordinance, rule, regulation, order, or the like, pursuant to which the security is issued.

(2) The following rules apply if an issuer asserts that a security is not valid:

(a) A security other than one issued by a government or governmental subdivision, agency, or instrumentality, even though issued with a defect going to its validity, is valid in the hands of a purchaser for value and without notice of the particular defect unless the defect involves a violation of a constitutional provision. In that case, the security is valid in the hands of a purchaser for value and without notice of the defect, other than one who takes by original issue.

(b) Paragraph (a) of this subsection applies to an issuer that is a government or governmental subdivision, agency or instrumentality only if there has been substantial compliance with the legal requirements governing the issue or the issuer has received a substantial consideration for the issue as a whole or for the particular security and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security.

(3) Except as otherwise provided in section 28-8-205[, Idaho Code], lack of genuineness of a certificated security is a complete defense, even against a purchaser for value and without notice.

(4) All other defenses of the issuer of a security, including nondelivery and conditional delivery of a certificated security, are ineffective against a purchaser for value who has taken the certificated security without notice of the particular defense.

(5) This section does not affect the right of a party to cancel a contract for a security "when, as and if issued" or "when distributed" in the event of a material change in the character of the security that is the subject of the contract or in the plan or arrangement pursuant to which the security is to be issued or distributed.

(6) If a security is held by a securities intermediary against whom an entitlement holder has a security entitlement with respect to the security, the issuer may not assert any defense that the issuer could not assert if the entitlement holder held the security directly.

History.

I.C., § 28-8-202, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-202 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertion in subsection (3) was added by the compiler to conform to the statutory citation style.

Official Comment

1. In this Article the rights of the purchaser for value without notice are divided into two aspects, those against the issuer, and those against other claimants to the security. Part 2 of this Article, and especially this section, deal with rights against the issuer.

Subsection (a) states, in accordance with the prevailing case law, the right of the issuer (who prepares the text of the security) to include terms incorporated by adequate reference to an extrinsic source, so long as the terms so incorporated do not conflict with the stated terms. Thus, the

standard practice of referring in a bond or debenture to the trust indenture under which it is issued without spelling out its necessarily complex and lengthy provisions is approved. Every stock certificate refers in some manner to the charter or articles of incorporation of the issuer. At least where there is more than one class of stock authorized applicable corporation codes specifically require a statement or summary as to preferences, voting powers and the like. References to constitutions, statutes, ordinances, rules, regulations or orders are not so common, except in the obligations of governments or governmental agencies or units; but where appropriate they fit into the rule here stated.

Courts have generally held that an issuer is estopped from denying representations made in the text of a security. *Delaware-New Jersey Ferry Co. v. Leeds*, 21 Del. Ch. 279, 186 A. 913 (1936). Nor is a defect in form or the invalidity of a security normally available to the issuer as a defense. *Bonini v. Family Theatre Corporation*, 327 Pa. 273, 194 A. 498 (1937); *First National Bank of Fairbanks v. Alaska Airmotive*, 119 F.2d 267 (C.C.A. Alaska 1941).

2. The rule in subsection (a) requiring that the terms of a security be noted or referred to on the certificate is based on practices and expectations in the direct holding system for certificated securities. This rule does not express a general rule or policy that the terms of a security are effective only if they are communicated to beneficial owners in some particular fashion. Rather, subsection (a) is based on the principle that a purchaser who does obtain a certificate is entitled to assume that the terms of the security have been noted or referred to on the certificate. That policy does not come into play in a securities holding system in which purchasers do not take delivery of certificates.

The provisions of subsection (a) concerning notation of terms on security certificates are necessary only because paper certificates play such an important role for certificated securities that a purchaser should be protected against assertion of any defenses or rights that are not noted on the certificate. No similar problem exists with respect to uncertificated securities. The last sentence of subsection (a) is, strictly speaking, unnecessary, since it only recognizes the fact that the terms of an uncertificated security are determined by whatever other law or agreement governs the security. It is included only to preclude any inference that

uncertificated securities are subject to any requirement analogous to the requirement of notation of terms on security certificates.

The rule of subsection (a) applies to the indirect holding system only in the sense that if a certificated security has been delivered to the clearing corporation or other securities intermediary, the terms of the security should be noted or referred to on the certificate. If the security is uncertificated, that principle does not apply even at the issuer-clearing corporation level. The beneficial owners who hold securities through the clearing corporation are bound by the terms of the security, even though they do not actually see the certificate. Since entitlement holders in an indirect holding system have not taken delivery of certificates, the policy of subsection (a) does not apply.

3. The penultimate sentence of subsection (a) and all of subsection (b) embody the concept that it is the duty of the issuer, not of the purchaser, to make sure that the security complies with the law governing its issue. The penultimate sentence of subsection (a) makes clear that the issuer cannot, by incorporating a reference to a statute or other document, charge the purchaser with notice of the security's invalidity. Subsection (b) gives to a purchaser for value without notice of the defect the right to enforce the security against the issuer despite the presence of a defect that otherwise would render the security invalid. There are three circumstances in which a purchaser does not gain such rights: first, if the defect involves a violation of constitutional provisions, these rights accrue only to a subsequent purchaser, that is, one who takes other than by original issue. This Article leaves to the law of each particular State the rights of a purchaser on original issue of a security with a constitutional defect. No negative implication is intended by the explicit grant of rights to a subsequent purchaser.

Second, governmental issuers are distinguished in subsection (b) from other issuers as a matter of public policy, and additional safeguards are imposed before governmental issues are validated. Governmental issuers are estopped from asserting defenses only if there has been substantial compliance with the legal requirements governing the issue or if substantial consideration has been received and a stated purpose of the issue is one for which the issuer has power to borrow money or issue the security. The purpose of the substantial compliance requirement is to make certain that a mere technicality as, e.g., in the manner of publishing election notices, shall

not be a ground for depriving an innocent purchaser of rights in the security. The policy is here adopted of such cases as *Tommie v. City of Gadsden*, 229 Ala. 521, 158 So. 763 (1935), in which minor discrepancies in the form of the election ballot used were overlooked and the bonds were declared valid since there had been substantial compliance with the statute.

A long and well established line of federal cases recognizes the principle of estoppel in favor of purchasers for value without notices where municipalities issue bonds containing recitals of compliance with governing constitutional and statutory provisions, made by the municipal authorities entrusted with determining such compliance. *Chaffee County v. Potter*, 142 U.S. 355 (1892); *Oregon v. Jennings*, 119 U.S. 74 (1886); *Gunnison County Commissioners v. Rollins*, 173 U.S. 255 (1898). This rule has been qualified, however, by requiring that the municipality have power to issue the security. *Anthony v. County of Jasper*, 101 U.S. 693 (1879); *Town of South Ottawa v. Perkins*, 94 U.S. 260 (1876). This section follows the case law trend, simplifying the rule by setting up two conditions for an estoppel against a governmental issuer: (1) substantial consideration given, and (2) power in the issuer to borrow money or issue the security for the stated purpose. As a practical matter the problem of policing governmental issuers has been alleviated by the present practice of requiring legal opinions as to the validity of the issue. The bulk of the case law on this point is nearly 100 years old and it may be assumed that the question now seldom arises.

Section 8-210, regarding overissue, provides the third exception to the rule that an innocent purchase for value takes a valid security despite the presence of a defect that would otherwise give rise to invalidity. See that section and its Comment for further explanation.

4. Subsection (e) is included to make clear that this section does not affect the presently recognized right of either party to a "when, as and if" or "when distributed" contract to cancel the contract on substantial change.

5. Subsection (f) has been added because the introduction of the security entitlement concept requires some adaptation of the Part 2 rules, particularly those that distinguish between purchasers who take by original issue and subsequent purchasers. The basic concept of Part 2 is to apply to investment securities the principle of negotiable instruments law that an obligor is precluded from asserting most defenses against purchasers for

value without notice. Section 8-202 describes in some detail which defenses issuers can raise against purchasers for value and subsequent purchasers for value. Because these rules were drafted with the direct holding system in mind, some interpretive problems might be presented in applying them to the indirect holding. For example, if a municipality issues a bond in book-entry only form, the only direct "purchaser" of that bond would be the clearing corporation. The policy of precluding the issuer from asserting defenses is, however, equally applicable. Subsection (f) is designed to ensure that the defense preclusion rules developed for the direct holding system will also apply to the indirect holding system.

Definitional Cross References:

"Certificated security". Section 8-102(a)(4).

"Notice". Section 1-201(25).

"Purchaser". Sections 1-201(30) & 8-116.

"Security". Section 8-102(a)(15).

"Uncertificated security". Section 8-102(a)(18).

"Value". Sections 1-201(44) [now 1-204] & 8-116.

§ 28-8-203. Staleness as notice of defect or defense. — After an act or event, other than a call that has been revoked, creating a right to immediate performance of the principal obligation represented by a certificated security or setting a date on or after which the security is to be presented or surrendered for redemption or exchange, a purchaser is charged with notice of any defect in its issue or defense of the issuer, if the act or event:

(1) Requires the payment of money, the delivery of a certificated security, the registration of transfer of an uncertificated security, or any of them on presentation or surrender of the security certificate, the money or security is available on the date set for payment or exchange, and the purchaser takes the security more than one (1) year after that date; or (2) Is not covered by subsection (1) of this section and the purchaser takes the security more than two (2) years after the date set for surrender or presentation or the date on which performance became due.

History.

I.C., § 28-8-203, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-203 was repealed. See Prior Laws, § 28-8-101.

Official Comment

1. The problem of matured or called securities is here dealt with in terms of the effect of such events in giving notice of the issuer's defenses and not in terms of "negotiability". The substance of this section applies only to certificated securities because certificates may be transferred to a purchaser by delivery after the security has matured, been called, or become redeemable or exchangeable. It is contemplated that uncertificated securities which have matured or been called will merely be canceled on the books of the issuer and the proceeds sent to the registered owner. Uncertificated

securities which have become redeemable or exchangeable, at the option of the owner, may be transferred to a purchaser, but the transfer is effectuated only by registration of transfer, thus necessitating communication with the issuer. If defects or defenses in such securities exist, the issuer will necessarily have the opportunity to bring them to the attention of the purchaser.

2. The fact that a security certificate is in circulation long after it has been called for redemption or exchange must give rise to the question in a purchaser's mind as to why it has not been surrendered. After the lapse of a reasonable period of time a purchaser can no longer claim "no reason to know" of any defects or irregularities in its issue. Where funds are available for the redemption the security certificate is normally turned in more promptly and a shorter time is set as the "reasonable period" than is set where funds are not available.

Defaulted certificated securities may be traded on financial markets in the same manner as unmatured and undefaulted instruments and a purchaser might not be placed upon notice of irregularity by the mere fact of default. An issuer, however, should at some point be placed in a position to determine definitely its liability on an invalid or improper issue, and for this purpose a security under this section becomes "stale" two years after the default. A different rule applies when the question is notice not of issuer's defenses but of claims of ownership. Section 8-105 and Comment.

3. Nothing in this section is designed to extend the life of preferred stocks called for redemption as "shares of stock" beyond the redemption date. After such a call, the security represents only a right to the funds set aside for redemption.

Definitional Cross References: "Certificated security". Section 8-102(a)(4).

"Notice". Section 1-201(25).

"Purchaser". Sections 1-201(30) & 8-116.

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-204. Effect of issuer's restriction on transfer. — A restriction on transfer of a security imposed by the issuer, even if otherwise lawful, is ineffective against a person without knowledge of the restriction unless:

(1) Security is certificated and the restriction is noted conspicuously on the security certificate; or (2) The security is uncertificated and the registered owner has been notified of the restriction.

History.

I.C., § 28-8-204, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-204 was repealed. See Prior Laws, § 28-8-101.

CASE NOTES

Decisions Under Prior Law

Allowable Restrictions.

Under the provisions of the Uniform Stock Transfer Act, restrictions relative to transfer of certificate were allowed provided they were printed thereon, were reasonable, and were not contrary to law or public policy. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944).

Conversion of Certificate.

Where corporation refused to transfer certificate on the ground that the transfer would be a violation of the corporation by-laws, which restriction did not appear on the certificate, the act of the corporation constituted conversion. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944).

Where corporation was to retain certain shares of plaintiff's stock under promotion agreement for issuance to third party provided latter performed certain conditions within limited time, after expiration of time defendant became liable for conversion when it refused to deliver stock to plaintiff. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944).

Official Comment

1. Restrictions on transfer of securities are imposed by issuers in a variety of circumstances and for a variety of purposes, such as to retain control of a close corporation or to ensure compliance with federal securities laws. Other law determines whether such restrictions are permissible. This section deals only with the consequences of failure to note the restriction on a security certificate.

This section imposes no bar to enforcement of a restriction on transfer against a person who has actual knowledge of it.

2. A restriction on transfer of a certificated security is ineffective against a person without knowledge of the restriction unless the restriction is noted conspicuously on the certificate. The word "noted" is used to make clear that the restriction need not be set forth in full text. Refusal by an issuer to register a transfer on the basis of an unnoted restriction would be a violation of the issuer's duty to register under Section 8-401.

3. The policy of this section is the same as in Section 8-202. A purchaser who takes delivery of a certificated security is entitled to rely on the terms stated on the certificate. That policy obviously does not apply to uncertificated securities. For uncertificated securities, this section requires only that the registered owner has been notified of the restriction. Suppose, for example, that A is the registered owner of an uncertificated security, and that the issuer has notified A of a restriction on transfer. A agrees to sell the security to B, in violation of the restriction. A completes a written instruction directing the issuer to register transfer to B, and B pays A for the security at the time A delivers the instruction to B. A does not inform B of the restriction, and B does not otherwise have notice or knowledge of it at the time B pays and receives the instruction. B presents the instruction to the issuer, but the issuer refuses to register the transfer on the grounds that it

would violate the restriction. The issuer has complied with this section, because it did notify the registered owner A of the restriction. The issuer's refusal to register transfer is not wrongful. B has an action against A for breach of transfer warranty, see Section 8-108(b)(4)(iii). B's mistake was treating an uncertificated security transaction in the fashion appropriate only for a certificated security. The mechanism for transfer of uncertificated securities is registration of transfer on the books of the issuer; handing over an instruction only initiates the process. The purchaser should make arrangements to ensure that the price is not paid until it knows that the issuer has or will register transfer.

4. In the indirect holding system, investors neither take physical delivery of security certificates nor have uncertificated securities registered in their names. So long as the requirements of this section have been satisfied at the level of the relationship between the issuer and the securities intermediary that is a direct holder, this section does not preclude the issuer from enforcing a restriction on transfer. See Section 8-202(a) and Comment 2 thereto.

5. This section deals only with restrictions imposed by the issuer. Restrictions imposed by statute are not affected. See *Quiner v. Marblehead Social Co.*, 10 Mass. 476 (1813); *Madison Bank v. Price*, 79 Kan. 289, 100 P. 280 (1909); *Healey v. Steele Center Creamery Ass'n*, 115 Minn. 451, 133 N.W. 69 (1911). Nor does it deal with private agreements between stockholders containing restrictive covenants as to the sale of the security.

Definitional Cross References: "Certificated security". Section 8-102(a)(4).

"Conspicuous". Section 1-201(10).

"Issuer". Section 8-201.

"Knowledge". Section 1-201(25).

"Notify". Section 1-201(25).

"Purchaser". Sections 1-201(30) & 8-116.

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

“Uncertificated security”. Section 8-102(a)(18).

§ 28-8-205. Effect of unauthorized signature on security certificate. —

An unauthorized signature placed on a security certificate before or in the course of issue is ineffective, but the signature is effective in favor of a purchaser for value of the certificated security if the purchaser is without notice of the lack of authority and the signing has been done by:

(1) An authenticating trustee, registrar, transfer agent or other person entrusted by the issuer with the signing of the security certificate or of similar security certificates, or the immediate preparation for signing of any of them; or (2) An employee of the issuer, or of any of the persons listed in subsection (1) of this section, entrusted with responsible handling of the security certificate.

History.

I.C., § 28-8-205, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-205 was repealed. See Prior Laws, § 28-8-101.

Official Comment

1. The problem of forged or unauthorized signatures may arise where an employee of the issuer, transfer agent, or registrar has access to securities which the employee is required to prepare for issue by affixing the corporate seal or by adding a signature necessary for issue. This section is based upon the issuer's duty to avoid the negligent entrusting of securities to such persons. Issuers have long been held responsible for signatures placed upon securities by parties whom they have held out to the public as authorized to prepare such securities. See *Fifth Avenue Bank of New York v. The Forty-Second & Grand Street Ferry Railroad Co*., 137 N.Y. 231, 33 N.E. 378, 19 L.R.A. 331, 33 Am. St. Rep. 712 (1893); *Jarvis v. Manhattan Beach Co*., 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am. St. Rep. 727 (1896). The "apparent authority" concept of some of the case-law, however,

is here extended and this section expressly rejects the technical distinction, made by courts reluctant to recognize forged signatures, between cases where forgers sign signatures they are authorized to sign under proper circumstances and those in which they sign signatures they are never authorized to sign. *Citizens' & Southern National Bank v. Trust Co. of Georgia*, 50 Ga. App. 681, 179 S.E. 278 (1935). Normally the purchaser is not in a position to determine which signature a forger, entrusted with the preparation of securities, has "apparent authority" to sign. The issuer, on the other hand, can protect itself against such fraud by the careful selection and bonding of agents and employees, or by action over against transfer agents and registrars who in turn may bond their personnel.

2. The issuer cannot be held liable for the honesty of employees not entrusted, directly or indirectly, with the signing, preparation, or responsible handling of similar securities and whose possible commission of forgery it has no reason to anticipate. The result in such cases as *Hudson Trust Co. v. American Linseed Co.*, 232 N.Y. 350, 134 N.E. 178 (1922), and *Dollar Savings Fund & Trust Co. v. Pittsburgh Plate Glass Co.*, 213 Pa. 307, 62 A. 916, 5 Ann. Cas. 248 (1906) is here adopted.

3. This section is not concerned with forged or unauthorized indorsements, but only with unauthorized signatures of issuers, transfer agents, etc., placed upon security certificates during the course of their issue. The protection here stated is available to all purchasers for value without notice and not merely to subsequent purchasers.

Definitional Cross References: "Certificated security". Section 8-102(a)(4).

"Issuer". Section 8-201.

"Notice". Section 1-201(25).

"Purchaser". Sections 1-201(30) & 8-116.

"Security certificate". Section 8-102(a)(14).

"Unauthorized signature". Section 1-201(41).

§ 28-8-206. Completion or alteration of security certificate. — (1) If a security certificate contains the signatures necessary to its issue or transfer but is incomplete in any other respect:

(a) Any person may complete it by filling in the blanks as authorized; and

(b) Even if the blanks are incorrectly filled in, the security certificate as completed is enforceable by a purchaser who took it for value and without notice of the incorrectness.

(2) A complete security certificate that has been improperly altered, even if fraudulently, remains enforceable, but only according to its original terms.

History.

I.C., § 28-8-206, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-206 was repealed. See Prior Laws, § 28-8-101.

CASE NOTES

Decisions Under Prior Law

Alterations in a Blank Printed Form.

Changes in a blank printed form used to prepare a counterfeit cashier's check did not constitute alterations within an exclusion of liability for forgery or alterations of checks or drafts in a blanket bond. United Pac. Ins. Co. v. Idaho First Nat'l Bank, 378 F.2d 62 (9th Cir. 1967).

Official Comment

1. The problem of forged or unauthorized signatures necessary for the issue or transfer of a security is not involved here, and a person in possession of a blank certificate is not, by this section, given authority to fill

in blanks with such signatures. Completion of blanks left in a transfer instruction is dealt with elsewhere (Section 8-305(a)).

2. Blanks left upon issue of a security certificate are the only ones dealt with here, and a purchaser for value without notice is protected. A purchaser is not in a good position to determine whether blanks were completed by the issuer or by some person not authorized to complete them. On the other hand the issuer can protect itself by not placing its signature on the writing until the blanks are completed or, if it does sign before all blanks are completed, by carefully selecting the agents and employees to whom it entrusts the writing after authentication. With respect to a security certificate that is completed by the issuer but later is altered, the issuer has done everything it can to protect the purchaser and thus is not charged with the terms as altered. However, it is charged according to the original terms, since it is not thereby prejudiced. If the completion or alteration is obviously irregular, the purchaser may not qualify as a purchaser who took without notice under this section.

3. Only the purchaser who physically takes the certificate is directly protected. However, a transferee may receive protection indirectly through Section 8-302(a).

4. The protection granted a purchaser for value without notice under this section is modified to the extent that an overissue may result where an incorrect amount is inserted into a blank (Section 8-210).

Definitional Cross References: “Notice”. Section 1-201(25).

“Purchaser”. Sections 1-201(30) & 8-116.

“Security certificate”. Section 8-102(a)(16).

“Unauthorized signature”. Section 1-201(41).

“Value”. Sections 1-204 & 8-116.

§ 28-8-207. Rights and duties of issuer with respect to registered owners. — (1) Before due presentment for registration of transfer of a certificated security in registered form or of an instruction requesting registration of transfer of an uncertificated security, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner.

(2) This chapter does not affect the liability of the registered owner of a security for a call, assessment or the like.

History.

I.C., § 28-8-207, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-207 was repealed. See Prior Laws, § 28-8-101.

Official Comment

1. Subsection (a) states the issuer's right to treat the registered owner of a security as the person entitled to exercise all the rights of an owner. This right of the issuer is limited by the provisions of Part 4 of this article. Once there has been due presentation for registration of transfer, the issuer has a duty to register ownership in the name of the transferee. Section 8-401. Thus its right to treat the old registered owner as exclusively entitled to the rights of ownership must cease.

The issuer may under this section make distributions of money or securities to the registered owners of securities without requiring further proof of ownership, provided that such distributions are distributable to the owners of all securities of the same issue and the terms of the security do not require surrender of a security certificate as a condition of payment or exchange. Any such distribution shall constitute a defense against a claim for the same distribution by a person, even if that person is in possession of

the security certificate and is a protected purchaser of the security. See PEB Commentary No. 4, dated March 10, 1990.

2. Subsection (a) is permissive and does not require that the issuer deal exclusively with the registered owner. It is free to require proof of ownership before paying out dividends or the like if it chooses to. *Barbato v. Breeze Corporation*, 128 N.J.L. 309, 26 A.2d 53 (1942).

3. This section does not operate to determine who is finally entitled to exercise voting and other rights or to receive payments and distributions. The parties are still free to incorporate their own arrangements as to these matters in seller-purchaser agreements which may be definitive as between them.

4. No change in existing state laws as to the liability of registered owners for calls and assessments is here intended; nor is anything in this section designed to estop record holders from denying ownership when assessments are levied if they are otherwise entitled to do so under state law. See *State ex rel. Squire v. Murfey, Blosson & Co*., 131 Ohio St. 289, 2 N.E.2d 866 (1936); *Willing v. Delaplaine*, 23 F. Supp 579 (1937).

5. No interference is intended with the common practice of closing the transfer books or taking a record date for dividend, voting, and other purposes, as provided for in by-laws, charters, and statutes.

Definitional Cross References: “Certificated security”. Section 8-102(a)(4).

“Instruction”. Section 8-102(a)(12).

“Issuer”. Section 8-201.

“Registered form”. Section 8-102(a)(13).

“Security”. Section 8-102(a)(15).

“Uncertificated security”. Section 8-102(a)(18).

§ 28-8-208. Effect of signature of authenticating trustee, registrar or transfer agent. — (1) A person signing a security certificate as authenticating trustee, registrar, transfer agent, or the like, warrants to a purchaser for value of the certificated security, if the purchaser is without notice of a particular defect, that:

(a) The certificate is genuine; (b) The person's own participation in the issue of the security is within the person's capacity and within the scope of the authority received by the person from the issuer; and (c) The person has reasonable grounds to believe that the certificated security is in the form and within the amount the issuer is authorized to issue.

(2) Unless otherwise agreed, a person signing under subsection (1) of this section does not assume responsibility for the validity of the security in other respects.

History.

I.C., § 28-8-208, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-208 was repealed. See Prior Laws, § 28-8-101.

Official Comment

1. The warranties here stated express the current understanding and prevailing case law as to the effect of the signatures of authenticating trustees, transfer agents, and registrars. See *Jarvis v. Manhattan Beach Co.*, 148 N.Y. 652, 43 N.E. 68, 31 L.R.A. 776, 51 Am. St. Rep. 727 (1896).Although it has generally been regarded as the particular obligation of the transfer agent to determine whether securities are in proper form as provided by the by-laws and Articles of Incorporation, neither a registrar nor an authenticating trustee should properly place a signature upon a certificate without determining whether it is at least regular on its face. The obligations of these parties in this respect have therefore been made explicit

in terms of due care. See *Feldmeier v. Mortgage Securities, Inc.*, 34 Cal. App. 2d 201, 93 P.2d 593 (1939).

2. Those cases which hold that an authenticating trustee is not liable for any defect in the mortgage or property which secures the bond or for any fraudulent misrepresentations made by the issuer are not here affected since these matters do not involve the genuineness or proper form of the security. *Ainsa v. Mercantile Trust Co*., 174 Cal. 504, 163 P. 898 (1917); *Tschetinian v. City Trust Co*., 186 N.Y. 432, 79 N.E. 401 (1906); *Davidge v. Guardian Trust Co. of New York*, 203 N.Y. 331, 96 N.E. 751 (1911).

3. The charter or an applicable statute may affect the capacity of a bank or other corporation undertaking to act as an authenticating trustee, registrar, or transfer agent. See, for example, the Federal Reserve Act (U.S.C., Title 12, Banks and Banking, Section 248) under which the Board of Governors of the Federal Reserve Bank is authorized to grant special permits to National Banks permitting them to act as trustees. Such corporations are therefore held to certify as to their legal capacity to act as well as to their authority.

4. Authenticating trustees, registrars, and transfer agents have normally been held liable for an issue in excess of the authorized amount. *Jarvis v. Manhattan Beach Co*., supra; *Mullen v. Eastern Trust & Banking Co*., 108 Me. 498, 81 A. 948 (1911). In imposing upon these parties a duty of due care with respect to the amount they are authorized to help issue, this section does not necessarily validate the security, but merely holds persons responsible for the excess issue liable in damages for any loss suffered by the purchaser.

5. Aside from questions of genuineness and excess issue, these parties are not held to certify as to the validity of the security unless they specifically undertake to do so. The case law which has recognized a unique responsibility on the transfer agent's part to testify as to the validity of any security which it countersigns is rejected.

6. This provision does not prevent a transfer agent or issuer from agreeing with a registrar of stock to protect the registrar in respect of the genuineness and proper form of a security certificate signed by the issuer or the transfer agent or both. Nor does it interfere with proper indemnity

arrangements between the issuer and trustees, transfer agents, registrars, and the like.

7. An unauthorized signature is a signature for purposes of this section if and only if it is made effective by Section 8-205.

Definitional Cross References: “Certificated security”. Section 8-102(a)(4).

“Genuine”. Section 1-201(19).

“Issuer”. Section 8-201.

“Notice”. Section 1-201(25).

“Purchaser”. Sections 1-201(30) & 8-116.

“Security”. Section 8-102(a)(15).

“Security certificate”. Section 8-102(a)(16).

“Uncertificated security”. Section 8-102(a)(18).

“Value”. Sections 1-204 & 8-116.

§ 28-8-209. Issuer's lien. — A lien in favor of an issuer upon a certificated security is valid against a purchaser only if the right of the issuer to the lien is noted conspicuously on the security certificate.

History.

I.C., § 28-8-209, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

This section is similar to Sections 8-202 and 8-204 which require that the terms of a certificated security and any restriction on transfer imposed by the issuer be noted on the security certificate. This section differs from those two sections in that the purchaser's knowledge of the issuer's claim is irrelevant. "Noted" makes clear that the text of the lien provisions need not be set forth in full. However, this would not override a provision of an applicable corporation code requiring statement *in haec verba* . This section does not apply to uncertificated securities. It applies to the indirect holding system in the same fashion as Sections 8-202 and 8-204, see Comment 2 to Section 8-202.

Definitional Cross References: "Certificated security". Section 8-102(a)(4).

"Issuer". Section 8-201.

"Purchaser". Sections 1-201(30) & 8-116.

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

§ 28-8-210. Overissue. — (1) In this section, "overissue" means the issue of securities in excess of the amount the issuer has corporate power to issue, but an overissue does not occur if appropriate action has cured the overissue.

(2) Except as otherwise provided in subsections (3) and (4) of this section, the provisions of this chapter which validate a security or compel its issue or reissue do not apply to the extent that validation, issue or reissue would result in overissue.

(3) If an identical security not constituting an overissue is reasonably available for purchase, a person entitled to issue or validation may compel the issuer to purchase the security and deliver it if certificated or register its transfer if uncertificated, against surrender of any security certificate the person holds.

(4) If a security is not reasonably available for purchase, a person entitled to issue or validation may recover from the issuer the price the person or the last purchaser for value paid for it with interest from the date of the person's demand.

History.

I.C., § 28-8-210, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. Deeply embedded in corporation law is the conception that "corporate power" to issue securities stems from the statute, either general or special, under which the corporation is organized. Corporation codes universally require that the charter or articles of incorporation state, at least as to capital shares, maximum limits in terms of number of shares or total dollar capital. Historically, special incorporation statutes are similarly drawn and sometimes similarly limit the face amount of authorized debt securities. The theory is that issue of securities in excess of the authorized amounts is prohibited. See, for example, *McWilliams v. Geddes & Moss Undertaking Co.*, 169 So. 894 (1936, La.); *Crawford v. Twin City Oil Co.*, 216 Ala. 216, 113 So. 61 (1927); *New York and New Haven R.R. Co. v. Schuyler*, 34 N.Y.

30 (1865). This conception persists despite modern corporation codes under which, by action of directors and stockholders, additional shares can be authorized by charter amendment and thereafter issued. This section does not give a person entitled to validation, issue, or reissue of a security, the right to compel amendment of the charter to authorize additional shares. Therefore, in a case where issue of an additional security would require charter amendment, the plaintiff is limited to the two alternate remedies set forth in subsections (c) and (d). The last clause of subsection (a), which is added in Revised Article 8, does, however, recognize that under modern conditions, overissue may be a relatively minor technical problem that can be cured by appropriate action under governing corporate law.

2. Where an identical security is reasonably available for purchase, whether because traded on an organized market, or because one or more security owners may be willing to sell at a not unreasonable price, the issuer, although unable to issue additional shares, will be able to purchase them and may be compelled to follow that procedure. *West v. Tintic Standard Mining Co*., 71 Utah 158, 263 P. 490 (1928).

3. The right to recover damages from an issuer who has permitted an overissue to occur is well settled. *New York and New Haven R.R. Co. v. Schuyler*, 34 N.Y. 30 (1865). The measure of such damages, however, has been open to question, some courts basing them upon the value of stock at the time registration is refused; some upon the value at the time of trial; and some upon the highest value between the time of refusal and the time of trial. *Allen v. South Boston Railroad*, 150 Mass. 200, 22 N.E. 917, 5 L.R.A. 716, 15 Am. St. Rep. 185 (1889); *Commercial Bank v. Kortright*, 22 Wend. (N.Y.) 348 (1839). The purchase price of the security to the last purchaser who gave value for it is here adopted as being the fairest means of reducing the possibility of speculation by the purchaser. Interest may be recovered as the best available measure of compensation for delay.

Definitional Cross References: "Issuer". Section 8-201.

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

"Uncertificated security". Section 8-102(a)(18).

Part 3
Transfer of Certificated and Uncertificated Securities

§ 28-8-301. Delivery. — (1) Delivery of a certificated security to a purchaser occurs when:

(a) The purchaser acquires possession of the security certificate; (b) Another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser; or (c) A securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and is: (i) registered in the name of the purchaser, (ii) payable to the order of the purchaser, or (iii) specially indorsed to the purchaser by an effective indorsement and has not been indorsed to the securities intermediary or in blank.

(2) Delivery of an uncertificated security to a purchaser occurs when: (a) The issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or (b) Another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser.

History.

I.C., § 28-8-301, as added by 1995, ch. 272, § 2, p. 873; am. 2001, ch. 208, § 17, p. 704.

STATUTORY NOTES

Prior Laws.

Former § 28-8-301 was repealed. See Prior Laws, § 28-1-101.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

Official Comment

1. This section specifies the requirements for "delivery" of securities. Delivery is used in Article 8 to describe the formal steps necessary for a purchaser to acquire a direct interest in a security under this Article. The concept of delivery refers to the implementation of a transaction, not the legal categorization of the transaction which is consummated by delivery. Issuance and transfer are different kinds of transaction, though both may be implemented by delivery. Sale and pledge are different kinds of transfers, but both may be implemented by delivery.

2. Subsection (a) defines delivery with respect to certificated securities. Paragraph (1) deals with simple cases where purchasers themselves acquire physical possession of certificates. Paragraphs (2) and (3) of subsection (a) specify the circumstances in which delivery to a purchaser can occur although the certificate is in the possession of a person other than the purchaser. Paragraph (2) contains the general rule that a purchaser can take delivery through another person, so long as the other person is actually acting on behalf of the purchaser or acknowledges that it is holding on behalf of the purchaser. Paragraph (2) does not apply to acquisition of possession by a securities intermediary, because a person who holds securities through a securities account acquires a security entitlement, rather than having a direct interest. See Section 8-501. Subsection (a)(3) specifies the limited circumstances in which delivery of security certificates to a securities intermediary is treated as a delivery to the customer. Note that delivery is a method of perfecting a security interest in a certificated security. See Section 9-313(a), (e).

3. Subsection (b) defines delivery with respect to uncertificated securities. Use of the term "delivery" with respect to uncertificated securities, does, at least on first hearing, seem a bit solecistic. The word "delivery" is, however, routinely used in the securities business in a broader sense than manual tradition. For example, settlement by entries on the books of a clearing corporation is commonly called "delivery," as in the expression "delivery versus payment." The diction of this section has the advantage of using the

same term for uncertificated securities as for certificated securities, for which delivery is conventional usage. Paragraph (1) of subsection (b) provides that delivery occurs when the purchaser becomes the registered owner of an uncertificated security, either upon original issue or registration of transfer. Paragraph (2) provides for delivery of an uncertificated security through a third person, in a fashion analogous to subsection (a)(2).

Definitional Cross References: “Certificated security”. Section 8-102(a)(4).

“Effective”. Section 8-107.

“Issuer”. Section 8-201.

“Purchaser”. Sections 1-201(30) & 8-116.

“Registered form”. Section 8-102(a)(13).

“Securities intermediary”. Section 8-102(a)(14).

“Security certificate”. Section 8-102(a)(16).

“Special indorsement”. Section 8-304(a).

“Uncertificated security”. Section 8-102(a)(18).

§ 28-8-302. Rights of purchaser. — (1) Except as otherwise provided in subsections (2) and (3) of this section, a purchaser of a certificated or uncertificated security acquires all rights in the security that the transferor had or had power to transfer.

(2) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(3) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser.

History.

I.C., § 28-8-302, as added by 1995, ch. 272, § 2, p. 873; am. 2001, ch. 208, § 18, p. 704.

STATUTORY NOTES

Prior Laws.

Former § 28-8-302 was repealed. See Prior Laws, § 28-8-101.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

Official Comment

1. Subsection (a) provides that a purchaser of a certificated or uncertificated security acquires all rights that the transferor had or had power to transfer. This statement of the familiar "shelter" principle is qualified by the exceptions that a purchaser of a limited interest acquires only that interest, subsection (b), and that a person who does not qualify as a protected purchaser cannot improve its position by taking from a subsequent protected purchaser, subsection (c).

2. Although this section provides that a purchaser acquires a property interest in a certificated or uncertificated security, it does not state that a

person can acquire an interest in a security only by purchase. Article 8 also is not a comprehensive codification of all of the law governing the creation or transfer of interests in securities. For example, the grant of a security interest is a transfer of a property interest, but the formal steps necessary to effectuate such a transfer are governed by Article 9 not by Article 8. Under the Article 9 rules, a security interest in a certificated or uncertificated security can be created by execution of a security agreement under Section 9-203 and can be perfected by filing. A transfer of an Article 9 security interest can be implemented by an Article 8 delivery, but need not be.

Similarly, Article 8 does not determine whether a property interest in certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies. Nor does Article 8 deal with transfers by operation of law. For example, transfers from decedent to administrator, from ward to guardian, and from bankrupt to trustee in bankruptcy are governed by other law as to both the time they occur and the substance of the transfer. The Article 8 rules do, however, determine whether the issuer is obligated to recognize the rights that a third party, such as a transferee, may acquire under other law. See Sections 8-207, 8-401, and 8-404.

Definitional Cross References: "Certificated security". Section 8-102(a)(4).

"Notice of adverse claim". Section 8-105.

"Protected purchaser". Section 8-303.

"Purchaser". Sections 1-201(30) & 8-116.

"Uncertificated security". Section 8-102(a)(18).

"Delivery". Section 8-301.

§ 28-8-303. Protected purchaser. — (1) "Protected purchaser" means a purchaser of a certificated or uncertificated security, or of an interest therein, who:

(a) Gives value;

(b) Does not have notice of any adverse claim to the security; and (c) Obtains control of the certificated or uncertificated security.

(2) In addition to acquiring the rights of a purchaser, a protected purchaser also acquires its interest in the security free of any adverse claim.

History.

I.C., § 28-8-303, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-303 was repealed. See Prior Laws, § 28-8-101.

CASE NOTES

Decisions Under Prior Law No Notice of Adverse Claim.

Where a bank could not have known that a joint owner of stock claimed rights to the pledged collateral, because her signature was forged, by extending credit the bank became a bona fide purchaser of the pledged securities after receiving delivery of the shares pursuant to a pledge agreement. Ogilvie v. Idaho Bank & Trust Co., 99 Idaho 361, 582 P.2d 215 (1978).

Official Comment

1. Subsection (a) lists the requirements that a purchaser must meet to qualify as a "protected purchaser." Subsection (b) provides that a protected purchaser takes its interest free from adverse claims. "Purchaser" is defined broadly in Section 1-201. A secured party as well as an outright buyer can

qualify as a protected purchaser. Also, "purchase" includes taking by issue, so a person to whom a security is originally issued can qualify as a protected purchaser.

2. To qualify as a protected purchaser, a purchaser must give value, take without notice of any adverse claim, and obtain control. Value is used in the broad sense defined in Section 1-201(44) [now 1-204]. See also Section 8-116 (securities intermediary as purchaser for value). Adverse claim is defined in Section 8-102(a)(1). Section 8-105 specifies whether a purchaser has notice of an adverse claim. Control is defined in Section 8-106. To qualify as a protected purchaser there must be a time at which all of the requirements are satisfied. Thus if a purchaser obtains notice of an adverse claim before giving value or satisfying the requirements for control, the purchaser cannot be a protected purchaser. See also Section 8-304(d).

The requirement that a protected purchaser obtain control expresses the point that to qualify for the adverse claim cut-off rule a purchaser must take through a transaction that is implemented by the appropriate mechanism. By contrast, the rules in Part 2 provide that any purchaser for value of a security without notice of a defense may take free of the issuer's defense based on that defense. See Section 8-202.

3. The requirements for control differ depending on the form of the security. For securities represented by bearer certificates, a purchaser obtains control by delivery. See Sections 8-106(a) and 8-301(a). For securities represented by certificates in registered form, the requirements for control are: (1) delivery as defined in Section 8-301(b), plus (2) either an effective indorsement or registration of transfer by the issuer. See Section 8-106(b). Thus, a person who takes through a forged indorsement does not qualify as a protected purchaser by virtue of the delivery alone. If, however, the purchaser presents the certificate to the issuer for registration of transfer, and the issuer registers transfer over the forged indorsement, the purchaser can qualify as a protected purchaser of the new certificate. If the issuer registers transfer on a forged indorsement, the true owner will be able to recover from the issuer for wrongful registration, see Section 8-404, unless the owner's delay in notifying the issuer of a loss or theft of the certificate results in preclusion under Section 8-406.

For uncertificated securities, a purchaser can obtain control either by delivery, see Sections 8-106(c)(1) and 8-301(b), or by obtaining an agreement pursuant to which the issuer agrees to act on instructions from the purchaser without further consent from the registered owner, see Section 8-106(c)(2). The control agreement device of Section 8-106(c)(2) takes the place of the "registered pledge" concept of the 1978 version of Article 8. A secured lender who obtains a control agreement under Section 8-106(c)(2) can qualify as a protected purchaser of an uncertificated security.

4. This section states directly the rules determining whether one takes free from adverse claims without using the phrase "good faith." Whether a person who takes under suspicious circumstances is disqualified is determined by the rules of Section 8-105 on notice of adverse claims. The term "protected purchaser," which replaces the term "bona fide purchaser" used in the prior version of Article 8, is derived from the term "protected holder" used in the Convention on International Bills and Notes prepared by the United Nations Commission on International Trade Law ("UNCITRAL").

Definitional Cross References: "Adverse claim". Section 8-102(a)(1).

"Certificated security". Section 8-102(a)(4).

"Control". Section 8-106.

"Notice of adverse claim". Section 8-105.

"Purchaser". Sections 1-201(30) & 8-116.

"Uncertificated security". Section 8-102(a)(18).

"Value". Sections 1-204 & 8-116.

§ 28-8-304. Indorsement. — (1) An indorsement may be in blank or special. An indorsement in blank includes an indorsement to bearer. A special indorsement specifies to whom a security is to be transferred or who has power to transfer it. A holder may convert a blank indorsement to a special indorsement.

(2) An indorsement purporting to be only of part of a security certificate representing units intended by the issuer to be separately transferable is effective to the extent of the indorsement.

(3) An indorsement, whether special or in blank, does not constitute a transfer until delivery of the certificate on which it appears or, if the indorsement is on a separate document, until delivery of both the document and the certificate.

(4) If a security certificate in registered form has been delivered to a purchaser without a necessary indorsement, the purchaser may become a protected purchaser only when the indorsement is supplied. However, against a transferor, a transfer is complete upon delivery and the purchaser has a specifically enforceable right to have any necessary indorsement supplied.

(5) An indorsement of a security certificate in bearer form may give notice of an adverse claim to the certificate, but it does not otherwise affect a right to registration that the holder possesses.

(6) Unless otherwise agreed, a person making an indorsement assumes only the obligations provided in section 28-8-108[, Idaho Code,] and not an obligation that the security will be honored by the issuer.

History.

I.C., § 28-8-304, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-304 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertion in subsection (6) was added by the compiler to conform to the statutory citation style.

Official Comment

1. By virtue of the definition of indorsement in Section 8-102 and the rules of this section, the simplified method of indorsing certificated securities previously set forth in the Uniform Stock Transfer Act is continued. Although more than one special indorsement on a given security certificate is possible, the desire for dividends or interest, as the case may be, should operate to bring the certificate home for registration of transfer within a reasonable period of time. The usual form of assignment which appears on the back of a stock certificate or in a separate "power" may be filled up either in the form of an assignment, a power of attorney to transfer, or both. If it is not filled up at all but merely signed, the indorsement is in blank. If filled up either as an assignment or as a power of attorney to transfer, the indorsement is special.

2. Subsection (b) recognizes the validity of a "partial" indorsement, e.g., as to fifty shares of the one hundred represented by a single certificate. The rights of a transferee under a partial indorsement to the status of a protected purchaser are left to the case law.

3. Subsection (c) deals with the effect of an indorsement without delivery. There must be a voluntary parting with control in order to effect a valid transfer of a certificated security as between the parties. *Levey v. Nason*, 279 Mass. 268, 181 N.E. 193 (1932), and *National Surety Co. v. Indemnity Insurance Co. of North America*, 237 App. Div. 485, 261 N.Y.S. 605 (1933). The provision in Section 10 of the Uniform Stock Transfer Act that an attempted transfer without delivery amounts to a promise to transfer is omitted. Even under that Act the effect of such a promise was left to the applicable law of contracts, and this Article by making no reference to such situations intends to achieve a similar result. With respect to delivery there is no counterpart to subsection (d) on right to compel indorsement, such as is envisaged in *Johnson v. Johnson*, 300 Mass. 24, 13 N.E.2d 788 (1938), where the transferee under a written assignment was given the right to compel a transfer of the certificate.

4. Subsection (d) deals with the effect of delivery without indorsement. As between the parties the transfer is made complete upon delivery, but the transferee cannot become a protected purchaser until indorsement is made. The indorsement does not operate retroactively, and notice may intervene between delivery and indorsement so as to prevent the transferee from becoming a protected purchaser. Although a purchaser taking without a necessary indorsement may be subject to claims of ownership, any issuer's defense of which the purchaser had no notice at the time of delivery will be cut off, since the provisions of this Article protect all purchasers for value without notice (Section 8-202).

The transferee's right to compel an indorsement where a security certificate has been delivered with intent to transfer is recognized in the case law. See *Coats v. Guaranty Bank & Trust Co*., 170 La. 871, 129 So. 513 (1930). A proper indorsement is one of the requisites of transfer which a purchaser of a certificated security has a right to obtain (Section 8-307). A purchaser may not only compel an indorsement under that section but may also recover for any reasonable expense incurred by the transferor's failure to respond to the demand for an indorsement.

5. Subsection (e) deals with the significance of an indorsement on a security certificate in bearer form. The concept of indorsement applies only to registered securities. A purported indorsement of bearer paper is normally of no effect. An indorsement "for collection," "for surrender" or the like, charges a purchaser with notice of adverse claims (Section 8-105(d)) but does not operate beyond this to interfere with any right the holder may otherwise possess to have the security registered.

6. Subsection (f) makes clear that the indorser of a security certificate does not warrant that the issuer will honor the underlying obligation. In view of the nature of investment securities and the circumstances under which they are normally transferred, a transferor cannot be held to warrant as to the issuer's actions. As a transferor the indorser, of course, remains liable for breach of the warranties set forth in this Article (Section 8-108).

Definitional Cross References:

"Bearer form". Section 8-102(a)(2).

"Certificated security". Section 8-102(a)(4).

“Indorsement”. Section 8-102(a)(11).

“Purchaser”. Sections 1-201(30) & 8-116.

“Registered form”. Section 8-102(a)(13).

“Security certificate”. Section 8-102(a)(16).

§ 28-8-305. Instruction. — (1) If an instruction has been originated by an appropriate person but is incomplete in any other respect, any person may complete it as authorized and the issuer may rely on it as completed, even though it has been completed incorrectly.

(2) Unless otherwise agreed, a person initiating an instruction assumes only the obligations imposed in section 28-8-108[, Idaho Code,] and not an obligation that the security will be honored by the issuer.

History.

I.C., § 28-8-305, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-305 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertion in subsection (2) was added by the compiler to conform to the statutory citation style.

Official Comment

1. The term instruction is defined in Section 8-102(a)(12) as a notification communicated to the issuer of an uncertificated security directing that transfer be registered. Section 8-107 specifies who may initiate an effective instruction.

Functionally, presentation of an instruction is quite similar to the presentation of an indorsed certificate for reregistration. Note that instruction is defined in terms of "communicate," see Section 8-102(a)(6). Thus, the instruction may be in the form of a writing signed by the registered owner or in any other form agreed upon by the issuer and the registered owner. Allowing nonwritten forms of instructions will permit the development and employment of means of transmitting instructions electronically.

When a person who originates an instruction leaves a blank and the blank later is completed, subsection (a) gives the issuer the same rights it would have had against the originating person had that person completed the blank. This is true regardless of whether the person completing the instruction had authority to complete it. Compare Section 8-206 and its Comment, dealing with blanks left upon issue.

2. Subsection (b) makes clear that the originator of an instruction, like the indorser of a security certificate, does not warrant that the issuer will honor the underlying obligation, but does make warranties as a transferor under Section 8-108.

Definitional Cross References: “Appropriate person”. Section 8-107.

“Instruction”. Section 8-102(a)(12).

“Issuer”. Section 8-201.

§ 28-8-306. Effect of guaranteeing signature, indorsement or instruction. — (1) A person who guarantees a signature of an indorser of a security certificate warrants that at the time of signing:

(a) The signature was genuine;

(b) The signer was an appropriate person to indorse, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person; and

(c) The signer had legal capacity to sign.

(2) A person who guarantees a signature of the originator of an instruction warrants that at the time of signing:

(a) The signature was genuine;

(b) The signer was an appropriate person to originate the instruction, or if the signature is by an agent, the agent had actual authority to act on behalf of the appropriate person, if the person specified in the instruction as the registered owner was, in fact, the registered owner, as to which fact the signature guarantor does not make a warranty; and

(c) The signer had legal capacity to sign.

(3) A person who specially guarantees the signature of an originator of an instruction makes the warranties of a signature guarantor under subsection (2) of this section and also warrants that at the time the instruction is presented to the issuer:

(a) The person specified in the instruction as the registered owner of the uncertificated security will be the registered owner; and

(b) The transfer of the uncertificated security requested in the instruction will be registered by the issuer free from all liens, security interests, restrictions and claims other than those specified in the instruction.

(4) A guarantor under subsections (1) and (2) of this section, or a special guarantor under subsection (3) of this section, does not otherwise warrant the rightfulness of the transfer.

(5) A person who guarantees an indorsement of a security certificate makes the warranties of a signature guarantor under subsection (1) of this section and also warrants the rightfulness of the transfer in all respects.

(6) A person who guarantees an instruction requesting the transfer of an uncertificated security makes the warranties of a special signature guarantor under subsection (3) of this section and also warrants the rightfulness of the transfer in all respects.

(7) An issuer may not require a special guaranty of signature, a guaranty of indorsement, or a guaranty of instruction as a condition to registration of transfer.

(8) The warranties under this section are made to a person taking or dealing with the security in reliance on the guaranty, and the guarantor is liable to the person for loss resulting from their breach. An indorser or originator of an instruction whose signature, indorsement, or instruction has been guaranteed is liable to a guarantor for any loss suffered by the guarantor as a result of breach of the warranties of the guarantor.

History.

I.C., § 28-8-306, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-306 was repealed. See Prior Laws, § 28-8-101.

Official Comment

1. Subsection (a) provides that a guarantor of the signature of the indorser of a security certificate warrants that the signature is genuine, that the signer is an appropriate person or has actual authority to indorse on behalf of the appropriate person, and that the signer has legal capacity. Subsection (b) provides similar, though not identical, warranties for the guarantor of a signature of the originator of an instruction for transfer of an uncertificated security.

Appropriate person is defined in Section 8-107(a) to include a successor or person who has power under other law to act for a person who is

deceased or lacks capacity. Thus if a certificate registered in the name of Mary Roe is indorsed by Jane Doe as executor of Mary Roe, a guarantor of the signature of Jane Doe warrants that she has power to act as executor.

Although the definition of appropriate person in Section 8-107(a) does not itself include an agent, an indorsement by an agent is effective under Section 8-107(b) if the agent has authority to act for the appropriate person. Accordingly, this section provides an explicit warranty of authority for agents.

2. The rationale of the principle that a signature guarantor warrants the authority of the signer, rather than simply the genuineness of the signature, was explained in the leading case of *Jennie Clarkson Home for Children v. Missouri, K. & T. R. Co.*, 182 N.Y. 47, 74 N.E. 571, 70 A.L.R. 787 (1905), which dealt with a guaranty of the signature of a person indorsing on behalf of a corporation. "If stock is held by an individual who is executing a power of attorney for its transfer, the member of the exchange who signs as a witness thereto guaranties not only the genuineness of the signature affixed to the power of attorney, but that the person signing is the individual in whose name the stock stands. With reference to stock standing in the name of a corporation, which can only sign a power of attorney through its authorized officers or agents, a different situation is presented. If the witnessing of the signature of the corporation is only that of the signature of a person who signs for the corporation, then the guaranty is of no value, and there is nothing to protect purchasers or the companies who are called upon to issue new stock in the place of that transferred from the frauds of persons who have signed the names of corporations without authority. If such is the only effect of the guaranty, purchasers and transfer agents must first go to the corporation in whose name the stock stands and ascertain whether the individual who signed the power of attorney had authority to so do. This will require time, and in many cases will necessitate the postponement of the completion of the purchase by the payment of the money until the facts can be ascertained. The broker who is acting for the owner has an opportunity to become acquainted with his customer, and may readily before sale ascertain, in case of a corporation, the name of the officer who is authorized to execute the power of attorney. It was therefore, we think, the purpose of the rule to cast upon the broker who witnesses the signature the duty of ascertaining whether the person signing the name of the corporation

had authority to so do, and making the witness a guarantor that it is the signature of the corporation in whose name the stock stands."

3. Subsection (b) sets forth the warranties that can reasonably be expected from the guarantor of the signature of the originator of an instruction, who, though familiar with the signer, does not have any evidence that the purported owner is in fact the owner of the subject uncertificated security. This is in contrast to the position of the person guaranteeing a signature on a certificate who can see a certificate in the signer's possession in the name of or indorsed to the signer or in blank. Thus, the warranty in paragraph (2) of subsection (b) is expressly conditioned on the actual registration's conforming to that represented by the originator. If the signer purports to be the owner, the guarantor under paragraph (2), warrants only the identity of the signer. If, however, the signer is acting in a representative capacity, the guarantor warrants both the signer's identity and authority to act for the purported owner. The issuer needs no warranty as to the facts of registration because those facts can be ascertained from the issuer's own records.

4. Subsection (c) sets forth a "special guaranty of signature" under which the guarantor additionally warrants both registered ownership and freedom from undisclosed defects of record. The guarantor of the signature of an indorser of a security certificate effectively makes these warranties to a purchaser for value on the evidence of a clean certificate issued in the name of the indorser, indorsed to the indorser or indorsed in blank. By specially guaranteeing under subsection (c), the guarantor warrants that the instruction will, when presented to the issuer, result in the requested registration free from defects not specified.

5. Subsection (d) makes clear that the warranties of a signature guarantor are limited to those specified in this section and do not include a general warranty of rightfulness. On the other hand subsections (e) and (f) provide that a person guaranteeing an indorsement or an instruction does warrant that the transfer is rightful in all respects.

6. Subsection (g) makes clear what can be inferred from the combination of Sections 8-401 and 8-402, that the issuer may not require as a condition to transfer a guaranty of the indorsement or instruction nor may it require a special signature guaranty.

7. Subsection (h) specifies to whom the warranties in this section run, and also provides that a person who gives a guaranty under this section has an action against the indorser or originator for any loss suffered by the guarantor.

Definitional Cross References:

"Appropriate person". Section 8-107.

"Genuine". Section 1-201(19).

"Indorsement". Section 8-102(a)(11).

"Instruction". Section 8-102(a)(12).

"Issuer". Section 8-201.

"Security certificate". Section 8-102(a)(16).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-307. Purchaser's right to requisites for registration of transfer. — Unless otherwise agreed, the transferor of a security on due demand shall supply the purchaser with proof of authority to transfer or with any other requisite necessary to obtain registration of the transfer of the security, but if the transfer is not for value, a transferor need not comply unless the purchaser pays the necessary expenses. If the transferor fails within a reasonable time to comply with the demand, the purchaser may reject or rescind the transfer.

History.

I.C., § 28-8-307, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-307 was repealed. See Prior Laws, § 28-8-101.

Official Comment

1. Because registration of the transfer of a security is a matter of vital importance, a purchaser is here provided with the means of obtaining such formal requirements for registration as signature guaranties, proof of authority, transfer tax stamps and the like. The transferor is the one in a position to supply most conveniently whatever documentation may be requisite for registration of transfer, and the duty to do so upon demand within a reasonable time is here stated affirmatively. If an essential item is peculiarly within the province of the transferor so that the transferor is the only one who can obtain it, the purchaser may specifically enforce the right to obtain it. Compare Section 8-304(d). If a transfer is not for value the transferor need not pay expenses.

2. If the transferor's duty is not performed the transferee may reject or rescind the contract to transfer. The transferee is not bound to do so. An action for damages for breach of contract may be preferred.

Definitional Cross References: "Purchaser". Sections 1-201(30) & 8-116.

"Security". Section 8-102(a)(15).

"Value". Sections 1-204 & 8-116.

§ 28-8-308 — 28-8-321. Indorsements — Instructions — Procedure — Transfer procedures — Creditors' rights — No conversions by good faith conduct — Statute of frauds — Transfer of pledge within central depository system — Enforceability, attachment, perfection and termination of security interests. [Repealed.]

STATUTORY NOTES

Prior Laws.

Former §§ 28-8-308 to 28-8-321 were repealed. See Prior Laws, § 28-8-101.

Part 4
Registration

Idaho Code § 28-8-401

§ 28-8-401. Duty of issuer to register transfer. — (1) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security, the issuer shall register the transfer as requested if:

(a) Under the terms of the security the person seeking registration of transfer is eligible to have the security registered in its name; (b) The indorsement or instruction is made by the appropriate person or by an agent who has actual authority to act on behalf of the appropriate person; (c) Reasonable assurance is given that the indorsement or instruction is genuine and authorized (section 28-8-402[, Idaho Code]); (d) Any applicable law relating to the collection of taxes has been complied with; (e) The transfer does not violate any restriction on transfer imposed by the issuer in accordance with section 28-8-204[, Idaho Code]; (f) A demand that the issuer not register transfer has not become effective under section 28-8-403[, Idaho Code], or the issuer has complied with section 28-8-403(2)[, Idaho Code], but no legal process or indemnity bond is obtained as provided in section 28-8-403(4)[, Idaho Code]; and (g) The transfer is in fact rightful or is to a protected purchaser.

(2) If an issuer is under a duty to register a transfer of a security, the issuer is liable to a person presenting a certificated security or an instruction for registration or to the person's principal for loss resulting from unreasonable delay in registration or failure or refusal to register the transfer.

History.

I.C., § 28-8-401, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-401 was repealed. See Prior Laws, § 28-1-101.

Compiler's Notes.

The bracketed insertions in paragraphs (1)(c), (1)(e), and (1)(f) were added by the compiler to conform to the statutory citation style.

The words enclosed in parentheses so appeared in the law as enacted.

CASE NOTES

Decisions Under Prior Law

Conspiracy.

In an action charging conspiracy on the part of officers and directors of the corporation in refusing to transfer plaintiff's stock, where the facts constituting conspiracy occurred after filing of complaint, plaintiff's right to recover against officers and directors was not strengthened thereby. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944).

Liability of Officers and Agents.

No individual liability attached to officers and agents of corporation for refusal to transfer stock certificate in absence of express statutory provision to the contrary. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944).

Waiver of Defense.

A corporation was bound to give its reasons for refusal to transfer stock upon its books and, where same were not given, they were waived and could not be raised as a defense for the first time during trial. Hulse v. Consolidated Quicksilver Mining Corp., 65 Idaho 768, 154 P.2d 149 (1944).

Official Comment

1. This section states the duty of the issuer to register transfers. A duty exists only if certain preconditions exist. If any of the preconditions do not exist, there is no duty to register transfer. If an indorsement on a security certificate is a forgery, there is no duty. If an instruction to transfer an uncertificated security is not originated by an appropriate person, there is no duty. If there has not been compliance with applicable tax laws, there is no duty. If a security certificate is properly indorsed but nevertheless the transfer is in fact wrongful, there is no duty unless the transfer is to a protected purchaser (and the other preconditions exist).

This section does not constitute a mandate that the issuer must establish that all preconditions are met before the issuer registers a transfer. The issuer may waive the reasonable assurances specified in paragraph (a)(3). If it has confidence in the responsibility of the persons requesting transfer, it may ignore questions of compliance with tax laws. Although an issuer has no duty if the transfer is wrongful, the issuer has no duty to inquire into adverse claims, see Section 8-404.

2. By subsection (b) the person entitled to registration may not only compel it but may hold the issuer liable in damages for unreasonable delay.

3. Section 8-201(c) provides that with respect to registration of transfer, "issuer" means the person on whose behalf transfer books are maintained. Transfer agents, registrars or the like within the scope of their respective functions have rights and duties under this Part similar to those of the issuer. See Section 8-407.

Definitional Cross References: "Appropriate person". Section 8-107.

"Certificated security". Section 8-102(a)(4).

"Genuine". Section 1-201(19).

"Indorsement". Section 8-102(a)(11).

"Instruction". Section 8-102(a)(12).

"Issuer". Section 8-201.

"Protected purchaser". Section 8-303.

"Registered form". Section 8-102(a)(13).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-402. Assurance that indorsement or instruction is effective. — (1) An issuer may require the following assurance that each necessary indorsement or each instruction is genuine and authorized:

(a) In all cases, a guaranty of the signature of the person making an indorsement or originating an instruction including, in the case of an instruction, reasonable assurance of identity;

(b) If the indorsement is made or the instruction is originated by an agent, appropriate assurance of actual authority to sign;

(c) If the indorsement is made or the instruction is originated by a fiduciary pursuant to section 28-8-107(1)(d) or (1)(e)[, Idaho Code], appropriate evidence of appointment or incumbency;

(d) If there is more than one (1) fiduciary, reasonable assurance that all who are required to sign have done so; and

(e) If the indorsement is made or the instruction is originated by a person not covered by another provision of this subsection, assurance appropriate to the case corresponding as nearly as may be to the provisions of this subsection.

(2) An issuer may elect to require reasonable assurance beyond that specified in this section.

(3) In this section:

(a) "Guaranty of the signature" means a guaranty signed by or on behalf of a person reasonably believed by the issuer to be responsible. An issuer may adopt standards with respect to responsibility if they are not manifestly unreasonable.

(b) "Appropriate evidence of appointment or incumbency" means:

(i) In the case of a fiduciary appointed or qualified by a court, a certificate issued by or under the direction or supervision of the court or an officer thereof and dated within sixty (60) days before the date of presentation for transfer; or

(ii) In any other case, a copy of a document showing the appointment or a certificate issued by or on behalf of a person reasonably believed by an issuer to be responsible or, in the absence of that document or certificate, other evidence the issuer reasonably considered appropriate.

History.

I.C., § 28-8-402, as added by 1995, ch. 272, § 2, p. 873; am. 2015, ch. 244, § 14, p. 1008.

STATUTORY NOTES

Prior Laws.

Former § 28-8-402 was repealed. See Prior Laws, § 28-8-101.

Amendments.

The 2015 amendment, by ch. 244, substituted "Appropriate" for "'Appropropriate" at the beginning of paragraph (3)(b).

Compiler's Notes.

The bracketed insertion in paragraph (1)(c) was added by the compiler to conform to the statutory citation style.

Official Comment

1. An issuer is absolutely liable for wrongful registration of transfer if the indorsement or instruction is ineffective. See Section 8-404. Accordingly, an issuer is entitled to require such assurance as is reasonable under the circumstances that all necessary indorsements are effective, and thus to minimize its risk. This section establishes the requirements the issuer may make in terms of documentation which, except in the rarest of instances, should be easily furnished. Subsection (b) provides that an issuer may require additional assurances if that requirement is reasonable under the circumstances, but if the issuer demands more than reasonable assurance that the instruction or the necessary indorsements are genuine and authorized, the presenter may refuse the demand and sue for improper refusal to register. Section 8-401(b).

2. Under subsection (a)(1), the issuer may require in all cases a guaranty of signature. See Section 8-306. When an instruction is presented the issuer always may require reasonable assurance as to the identity of the originator. Subsection (c) allows the issuer to require that the person making these guaranties be one reasonably believed to be responsible, and the issuer may adopt standards of responsibility which are not manifestly unreasonable. Regulations under the federal securities laws, however, place limits on the requirements transfer agents may impose concerning the responsibility of eligible signature guarantors. See 17 CFR 240.17Ad-15.

3. This section, by paragraphs (2) through (5) of subsection (a), permits the issuer to seek confirmation that the indorsement or instruction is genuine and authorized. The permitted methods act as a double check on matters which are within the warranties of the signature guarantor. See Section 8-306. Thus, an agent may be required to submit a power of attorney, a corporation to submit a certified resolution evidencing the authority of its signing officer to sign, an executor or administrator to submit the usual "short-form certificate," *etc*. But failure of a fiduciary to obtain court approval of the transfer or to comply with other requirements does not make the fiduciary's signature ineffective. Section 8-107(c). Hence court orders and other controlling instruments are omitted from subsection (a).

Subsection (a)(3) authorizes the issuer to require "appropriate evidence" of appointment or incumbency, and subsection (c) indicates what evidence will be "appropriate". In the case of a fiduciary appointed or qualified by a court that evidence will be a court certificate dated within sixty days before the date of presentation, subsection (c)(2)(i). Where the fiduciary is not appointed or qualified by a court, as in the case of a successor trustee, subsection (c)(2)(ii) applies. In that case, the issuer may require a copy of a trust instrument or other document showing the appointment, or it may require the certificate of a responsible person. In the absence of such a document or certificate, it may require other appropriate evidence. If the security is registered in the name of the fiduciary as such, the person's signature is effective even though the person is no longer serving in that capacity, see Section 8-107(d), hence no evidence of incumbency is needed.

4. Circumstances may indicate that a necessary signature was unauthorized or was not that of an appropriate person. Such circumstances

would be ignored at risk of absolute liability. To minimize that risk the issuer may properly exercise the option given by subsection (b) to require assurance beyond that specified in subsection (a). On the other hand, the facts at hand may reflect only on the rightfulness of the transfer. Such facts do not create a duty of inquiry, because the issuer is not liable to an adverse claimant unless the claimant obtains legal process. See Section 8-404.

Definitional Cross References:

“Appropriate person”. Section 8-107.

“Genuine”. Section 1-201(19).

“Indorsement”. Section 8-102(a)(11).

“Instruction”. Section 8-102(a)(12).

“Issuer”. Section 8-201.

§ 28-8-403. Demand that issuer not register transfer. — (1) A person who is an appropriate person to make an indorsement or originate an instruction may demand that the issuer not register transfer of a security by communicating to the issuer a notification that identifies the registered owner and the issue of which the security is a part and provides an address for communications directed to the person making the demand. The demand is effective only if it is received by the issuer at a time and in a manner affording the issuer reasonable opportunity to act on it.

(2) If a certificated security in registered form is presented to an issuer with a request to register transfer or an instruction is presented to an issuer with a request to register transfer of an uncertificated security after a demand that the issuer not register transfer has become effective, the issuer shall promptly communicate to (i) the person who initiated the demand at the address provided in the demand and (ii) the person who presented the security for registration of transfer or initiated the instruction requesting registration of transfer a notification stating that: (a) The certificated security has been presented for registration of transfer or instruction for registration of transfer of uncertificated security has been received; (b) A demand that the issuer not register transfer had previously been received; and (c) The issuer will withhold registration of transfer for a period of time stated in the notification in order to provide the person who initiated the demand an opportunity to obtain legal process or an indemnity bond.

(3) The period described in subsection (2)(c) of this section may not exceed thirty (30) days after the date of communication of the notification. A shorter period may be specified by the issuer if it is not manifestly unreasonable.

(4) An issuer is not liable to a person who initiated a demand that the issuer not register transfer for any loss the person suffers as a result of registration of a transfer pursuant to an effective indorsement or instruction if the person who initiated the demand does not, within the time stated in the issuer's communication, either: (a) Obtain an appropriate restraining order, injunction or other process from a court of competent jurisdiction

enjoining the issuer from registering the transfer; or (b) File with the issuer an indemnity bond, sufficient in the issuer's judgment to protect the issuer and any transfer agent, registrar or other agent of the issuer involved from any loss it or they may suffer by refusing to register the transfer.

(5) This section does not relieve an issuer from liability for registering transfer pursuant to an indorsement or instruction that was not effective.

History.

I.C., § 28-8-403, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-403 was repealed. See Prior Laws, § 28-8-101.

Official Comment

1. The general rule under this Article is that if there has been an effective indorsement or instruction, a person who contends that registration of the transfer would be wrongful should not be able to interfere with the registration process merely by sending notice of the assertion to the issuer. Rather, the claimant must obtain legal process. See Section 8-404. Section 8-403 is an exception to this general rule. It permits the registered owner — but not third parties — to demand that the issuer not register a transfer.

2. This section is intended to alleviate the problems faced by registered owners of certificated securities who lose or misplace their certificates. A registered owner who realizes that a certificate may have been lost or stolen should promptly report that fact to the issuer, lest the owner be precluded from asserting a claim for wrongful registration. See Section 8-406. The usual practice of issuers and transfer agents is that when a certificate is reported as lost, the owner is notified that a replacement can be obtained if the owner provides an indemnity bond. See Section 8-405. If the registered owner does not plan to transfer the securities, the owner might choose not to obtain a replacement, particularly if the owner suspects that the certificate has merely been misplaced.

Under this section, the owner's notification that the certificate has been lost would constitute a demand that the issuer not register transfer. No indemnity bond or legal process is necessary. If the original certificate is presented for registration of transfer, the issuer is required to notify the registered owner of that fact, and defer registration of transfer for a stated period. In order to prevent undue delay in the process of registration, the stated period may not exceed thirty days. This gives the registered owner an opportunity to either obtain legal process or post an indemnity bond and thereby prevent the issuer from registering transfer.

3. Subsection (e) makes clear that this section does not relieve an issuer from liability for registering a transfer pursuant to an ineffective indorsement. An issuer's liability for wrongful registration in such cases does not depend on the presence or absence of notice that the indorsement was ineffective. Registered owners who are confident that they neither indorsed the certificates, nor did anything that would preclude them from denying the effectiveness of another's indorsement, see Sections 8-107(b) and 8-406, might prefer to pursue their rights against the issuer for wrongful registration rather than take advantage of the opportunity to post a bond or seek a restraining order when notified by the issuer under this section that their lost certificates have been presented for registration in apparently good order.

Definitional Cross References: "Appropriate person". Section 8-107.

"Certificated security". Section 8-102(a)(4).

"Communicate". Section 8-102(a)(6).

"Effective". Section 8-107.

"Indorsement". Section 8-102(a)(11).

"Instruction". Section 8-102(a)(12).

"Issuer". Section 8-201.

"Registered form". Section 8-102(a)(13).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-404. Wrongful registration. — (1) Except as otherwise provided in section 28-8-406[, Idaho Code], an issuer is liable for wrongful registration of transfer if the issuer has registered a transfer of a security to a person not entitled to it, and the transfer was registered:

(a) Pursuant to an ineffective indorsement or instruction; (b) After a demand that the issuer not register transfer became effective under section 28-8-403(1)[, Idaho Code], and the issuer did not comply with section 28-8-403(2)[, Idaho Code]; (c) After the issuer had been served with an injunction, restraining order, or other legal process enjoining it from registering the transfer, issued by a court of competent jurisdiction, and the issuer had a reasonable opportunity to act on the injunction, restraining order or other legal process; or (d) By an issuer acting in collusion with the wrongdoer.

(2) An issuer that is liable for wrongful registration of transfer under subsection (1) of this section on demand shall provide the person entitled to the security with a like certificated or uncertificated security, and any payments or distributions that the person did not receive as a result of the wrongful registration. If an overissue would result, the issuer's liability to provide the person with a like security is governed by section 28-8-210[, Idaho Code].

(3) Except as otherwise provided in subsection (1) of this section or in a law relating to the collection of taxes, an issuer is not liable to an owner or other person suffering loss as a result of the registration of a transfer of a security if registration was made pursuant to an effective indorsement or instruction.

History.

I.C., § 28-8-404, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-404 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertions in the introductory paragraph in subsection (1), in paragraph (1)(b), and at the end of subsection (2) were added by the compiler to conform to the statutory citation style.

CASE NOTES

Determination of Ownership.

The registration of the transfer of stock does not conclusively determine the actual ownership of that stock in and of itself. Klaue v. Hern, 133 Idaho 437, 988 P.2d 211 (1999).

Official Comment

1. Subsection (a)(1) provides that an issuer is liable if it registers transfer pursuant to an indorsement or instruction that was not effective. For example, an issuer that registers transfer on a forged indorsement is liable to the registered owner. The fact that the issuer had no reason to suspect that the indorsement was forged or that the issuer obtained the ordinary assurances under Section 8-402 does not relieve the issuer from liability. The reason that issuers obtain signature guaranties and other assurances is that they are liable for wrongful registration.

Subsection (b) specifies the remedy for wrongful registration. Pre-Code cases established the registered owner's right to receive a new security where the issuer had wrongfully registered a transfer, but some cases also allowed the registered owner to elect between an equitable action to compel issue of a new security and an action for damages. Cf. *Casper v. Kalt-Zimmers Mfg. Co.*, 159 Wis. 517, 149 N.W. 754 (1914). Article 8 does not allow such election. The true owner of a certificated security is required to take a new security except where an overissue would result and a similar security is not reasonably available for purchase. See Section 8-210. The true owner of an uncertificated security is entitled and required to take restoration of the records to their proper state, with a similar exception for overissue.

2. Read together, subsections (c) and (a) have the effect of providing that an issuer has no duties to an adverse claimant unless the claimant serves

legal process on the issuer to enjoin registration. Issuers, or their transfer agents, perform a record-keeping function for the direct holding system that is analogous to the functions performed by clearing corporations and securities intermediaries in the indirect holding system. This section applies to the record-keepers for the direct holding system the same standard that Section 8-115 applies to the record-keepers for the indirect holding system. Thus, issuers are not liable to adverse claimants merely on the basis of notice. As in the case of the analogous rules for the indirect holding system, the policy of this section is to protect the right of investors to have their securities transfers processed without the disruption or delay that might result if the record-keepers risked liability to third parties. It would be undesirable to apply different standards to the direct and indirect holding systems, since doing so might operate as a disincentive to the development of a book-entry direct holding system.

3. This section changes prior law under which an issuer could be held liable, even though it registered transfer on an effective indorsement or instruction, if the issuer had in some fashion been notified that the transfer might be wrongful against a third party, and the issuer did not appropriately discharge its duty to inquire into the adverse claim. See Section 8-403 (1978).

The rule of former Section 8-403 was anomalous inasmuch as Section 8-207 provides that the issuer is entitled to "treat the registered owner as the person exclusively entitled to vote, receive notifications, and otherwise exercise all the rights and powers of an owner." Under Section 8-207, the fact that a third person notifies the issuer of a claim does not preclude the issuer from treating the registered owner as the person entitled to the security. See *Kerrigan v. American Orthodontics Corp.*, 960 F.2d 43 (7th Cir. 1992). The change made in the present version of Section 8-404 ensures that the rights of registered owners and the duties of issuers with respect to registration of transfer will be protected against third-party interference in the same fashion as other rights of registered ownership.

Definitional Cross References: "Certificated security". Section 8-102(a)(4).

"Effective". Section 8-107.

"Indorsement". Section 8-102(a)(11).

"Instruction". Section 8-102(a)(12).

"Issuer". Section 8-201.

"Security". Section 8-102(a)(15).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-405. Replacement of lost, destroyed, or wrongfully taken security certificate. — (1) If an owner of a certificated security, whether in registered or bearer form, claims that the certificate has been lost, destroyed or wrongfully taken, the issuer shall issue a new certificate if the owner:

(a) So requests before the issuer has notice that the certificate has been acquired by a protected purchaser; (b) Files with the issuer a sufficient indemnity bond; and (c) Satisfies other reasonable requirements imposed by the issuer.

(2) If, after the issue of a new security certificate, a protected purchaser of the original certificate presents it for registration of transfer, the issuer shall register the transfer unless an overissue would result. In that case, the issuer's liability is governed by section 28-8-210[, Idaho Code]. In addition to any rights on the indemnity bond, an issuer may recover the new certificate from a person to whom it was issued or any person taking under that person, except a protected purchaser.

History.

I.C., § 28-8-405, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-405 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertion in subsection (2) was added by the compiler to conform to the statutory citation style.

Official Comment

1. This section enables the owner to obtain a replacement of a lost, destroyed or stolen certificate, provided that reasonable requirements are satisfied and a sufficient indemnity bond supplied.

2. Where an “original” security certificate has reached the hands of a protected purchaser, the registered owner — who was in the best position to prevent the loss, destruction or theft of the security certificate — is now deprived of the new security certificate issued as a replacement. This changes the pre-UCC law under which the original certificate was ineffective after the issue of a replacement except insofar as it might represent an action for damages in the hands of a purchaser for value without notice. *Keller v. Eureka Brick Mach. Mfg. Co.*, 43 Mo. App. 84, 11 L.R.A. 472 (1890). Where both the original and the new certificate have reached protected purchasers the issuer is required to honor both certificates unless an overissue would result and the security is not reasonably available for purchase. See Section 8-210. In the latter case alone, the protected purchaser of the original certificate is relegated to an action for damages. In either case, the issuer itself may recover on the indemnity bond.

Definitional Cross References: “Bearer form”. Section 8-102(a)(2).

“Certificated security”. Section 8-102(a)(4).

“Issuer”. Section 8-201.

“Notice”. Section 1-202.

“Overissue”. Section 8-210.

“Protected purchaser”. Section 8-303.

“Registered form”. Section 8-102(a)(13).

“Security certificate”. Section 8-102(a)(16).

§ 28-8-406. Obligation to notify issuer of lost, destroyed or wrongfully taken security certificate. — If a security certificate has been lost, apparently destroyed or wrongfully taken, and the owner fails to notify the issuer of that fact within a reasonable time after the owner has notice of it and the issuer registers a transfer of the security before receiving notification, the owner may not assert against the issuer a claim for registering the transfer under section 28-8-404[, Idaho Code,] or a claim to a new security certificate under section 28-8-405[, Idaho Code].

History.

I.C., § 28-8-406, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-406 was repealed. See Prior Laws, § 28-8-101.

Compiler's Notes.

The bracketed insertions near the end of this section were added by the compiler to conform to the statutory citation style.

Official Comment An owner who fails to notify the issuer within a reasonable time after the owner knows or has reason to know of the loss or theft of a security certificate is estopped from asserting the ineffectiveness of a forged or unauthorized indorsement and the wrongfulness of the registration of the transfer. If the lost certificate was indorsed by the owner, then the registration of the transfer was not wrongful under Section 8-404, unless the owner made an effective demand that the issuer not register transfer under Section 8-403.

Definitional Cross References: "Issuer". Section 8-201.

"Notify". Section 1-202.

"Security certificate". Section 8-102(a)(16).

§ 28-8-407. Authenticating trustee, transfer agent, and registrar. — A person acting as authenticating trustee, transfer agent, registrar or other agent for an issuer in the registration of a transfer of its securities, in the issue of new security certificates or uncertificated securities, or in the cancellation of surrendered security certificates has the same obligation to the holder or owner of a certificated or uncertificated security with regard to the particular functions performed as the issuer has in regard to those functions.

History.

I.C., § 28-8-407, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Prior Laws.

Former § 28-8-407 was repealed. See Prior Laws, § 28-8-101.

Official Comment

1. Transfer agents, registrars, and the like are here expressly held liable both to the issuer and to the owner for wrongful refusal to register a transfer as well as for wrongful registration of a transfer in any case within the scope of their respective functions where the issuer would itself be liable. Those cases which have regarded these parties solely as agents of the issuer and have therefore refused to recognize their liability to the owner for mere nonfeasance, i.e., refusal to register a transfer, are rejected. *Hulse v. Consolidated Quicksilver Mining Corp*., 65 Idaho 768, 154 P.2d 149 (1944); *Nicholson v. Morgan*, 119 Misc. 309, 196 N.Y. Supp. 147 (1922); *Lewis v. Hargadine-McKittrick Dry Goods Co*., 305 Mo. 396, 274 S.W. 1041 (1924).

2. The practice frequently followed by authenticating trustees of issuing certificates of indebtedness rather than authenticating duplicate certificates where securities have been lost or stolen became obsolete in view of the provisions of Section 8-405, which makes express provision for the issue of

substitute securities. It is not a breach of trust or lack of due diligence for trustees to authenticate new securities. Cf. *Switzerland General Ins. Co. v. N.Y.C. & H.R.R. Co.*, 152 App. Div. 70, 136 N.Y.S. 726 (1912).

Definitional Cross References: "Certificated security". Section 8-102(a)(4).

"Issuer". Section 8-201.

"Security". Section 8-102(a)(15).

"Security certificate". Section 8-102(a)(16).

"Uncertificated security". Section 8-102(a)(18).

§ 28-8-408. Statements of uncertificated securities. [Repealed.]

STATUTORY NOTES

Prior Laws.

Former § 28-8-408 was repealed. See Prior Laws, § 28-8-101.

Part 5
Security Entitlements

Idaho Code § 28-8-501

§ 28-8-501. Securities account and acquisition of security entitlement from securities intermediary. — (1) "Securities account" means an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.

(2) Except as otherwise provided in subsections (4) and (5) of this section, a person acquires a security entitlement if a securities intermediary:

(a) Indicates by book entry that a financial asset has been credited to the person's securities account;

(b) Receives a financial asset from the person or acquires a financial asset for the person and, in either case, accepts it for credit to the person's securities account; or

(c) Becomes obligated under other law, regulation or rule to credit a financial asset to the person's securities account.

(3) If a condition of subsection (2) of this section has been met, a person has a security entitlement even though the securities intermediary does not itself hold the financial asset.

(4) If a securities intermediary holds a financial asset for another person, and the financial asset is registered in the name of, payable to the order of, or specially indorsed to the other person, and has not been indorsed to the securities intermediary or in blank, the other person is treated as holding the financial asset directly rather than as having a security entitlement with respect to the financial asset.

(5) Issuance of a security is not establishment of a security entitlement.

History.

I.C., § 28-8-501, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. Part 5 rules apply to security entitlements, and Section 8-501(b) provides that a person has a security entitlement when a financial asset has been credited to a "securities account." Thus, the term "securities account" specifies the type of arrangements between institutions and their customers that are covered by Part 5. A securities account is a consensual arrangement in which the intermediary undertakes to treat the customer as entitled to exercise the rights that comprise the financial asset. The consensual aspect is covered by the requirement that the account be established pursuant to agreement. The term agreement is used in the broad sense defined in Section 1-201(3). There is no requirement that a formal or written agreement be signed.

As the securities business is presently conducted, several significant relationships clearly fall within the definition of a securities account, including the relationship between a clearing corporation and its participants, a broker and customers who leave securities with the broker, and a bank acting as securities custodian and its custodial customers. Given the enormous variety of arrangements concerning securities that exist today, and the certainty that new arrangements will evolve in the future, it is not possible to specify all of the arrangements to which the term does and does not apply.

Whether an arrangement between a firm and another person concerning a security or other financial asset is a "securities account" under this Article depends on whether the firm has undertaken to treat the other person as entitled to exercise the rights that comprise the security or other financial asset. Section 1-102, however, states the fundamental principle of interpretation that the Code provisions should be construed and applied to promote their underlying purposes and policies. Thus, the question whether a given arrangement is a securities account should be decided not by dictionary analysis of the words of the definition taken out of context, but by considering whether it promotes the objectives of Article 8 to include the arrangement within the term securities account.

The effect of concluding that an arrangement is a securities account is that the rules of Part 5 apply. Accordingly, the definition of "securities account" must be interpreted in light of the substantive provisions in Part 5,

which describe the core features of the type of relationship for which the commercial law rules of Revised Article 8 concerning security entitlements were designed. There are many arrangements between institutions and other persons concerning securities or other financial assets which do not fall within the definition of "securities account" because the institutions have not undertaken to treat the other persons as entitled to exercise the ordinary rights of an entitlement holder specified in the Part 5 rules. For example, the term securities account does not cover the relationship between a bank and its depositors or the relationship between a trustee and the beneficiary of an ordinary trust, because those are not relationships in which the holder of a financial asset has undertaken to treat the other as entitled to exercise the rights that comprise the financial asset in the fashion contemplated by the Part 5 rules.

In short, the primary factor in deciding whether an arrangement is a securities account is whether application of the Part 5 rules is consistent with the expectations of the parties to the relationship. Relationships not governed by Part 5 may be governed by other parts of Article 8 if the relationship gives rise to a new security, or may be governed by other law entirely.

2. Subsection (b) of this section specifies what circumstances give rise to security entitlements. Paragraph (1) of subsection (b) sets out the most important rule. It turns on the intermediary's conduct, reflecting a basic operating assumption of the indirect holding system that once a securities intermediary has acknowledged that it is carrying a position in a financial asset for its customer or participant, the intermediary is obligated to treat the customer or participant as entitled to the financial asset. Paragraph (1) does not attempt to specify exactly what accounting, record-keeping, or information transmission steps suffice to indicate that the intermediary has credited the account. That is left to agreement, trade practice, or rule in order to provide the flexibility necessary to accommodate varying or changing accounting and information processing systems. The point of paragraph (1) is that once an intermediary has acknowledged that it is carrying a position for the customer or participant, the customer or participant has a security entitlement. The precise form in which the intermediary manifests that acknowledgment is left to private ordering.

Paragraph (2) of subsection (b) sets out a different operational test, turning not on the intermediary's accounting system but on the facts that accounting systems are supposed to represent. Under paragraph (b)(2) a person has a security entitlement if the intermediary has received and accepted a financial asset for credit to the account of its customer or participant. For example, if a customer of a broker or bank custodian delivers a security certificate in proper form to the broker or bank to be held in the customer's account, the customer acquires a security entitlement. Paragraph (b)(2) also covers circumstances in which the intermediary receives a financial asset from a third person for credit to the account of the customer or participant. Paragraph (b)(2) is not limited to circumstances in which the intermediary receives security certificates or other financial assets in physical form. Paragraph (b)(2) also covers circumstances in which the intermediary acquires a security entitlement with respect to a financial asset which is to be credited to the account of the intermediary's own customer. For example, if a customer transfers her account from Broker A to Broker B, she acquires security entitlements against Broker B once the clearing corporation has credited the positions to Broker B's account. It should be noted, however, that paragraph (b)(2) provides that a person acquires a security entitlement when the intermediary not only receives but also accepts the financial asset for credit to the account. This limitation is included to take account of the fact that there may be circumstances in which an intermediary has received a financial asset but is not willing to undertake the obligations that flow from establishing a security entitlement. For example, a security certificate which is sent to an intermediary may not be in proper form, or may represent a type of financial asset which the intermediary is not willing to carry for others. It should be noted that in all but extremely unusual cases, the circumstances covered by paragraph (2) will also be covered by paragraph (1), because the intermediary will have credited the positions to the customer's account.

Paragraph (3) of subsection (b) sets out a residual test, to avoid any implication that the failure of an intermediary to make the appropriate entries to credit a position to a customer's securities account would prevent the customer from acquiring the rights of an entitlement holder under Part 5. As is the case with the paragraph (2) test, the paragraph (3) test would not be needed for the ordinary cases, since they are covered by paragraph (1).

3. In a sense, Section 8-501(b) is analogous to the rules set out in the provisions of Sections 8-313(1)(d) and 8-320 of the prior version of Article 8 that specified what acts by a securities intermediary or clearing corporation sufficed as a transfer of securities held in fungible bulk. Unlike the prior version of Article 8, however, this section is not based on the idea that an entitlement holder acquires rights only by virtue of a "transfer" from the securities intermediary to the entitlement holder. In the indirect holding system, the significant fact is that the securities intermediary has undertaken to treat the customer as entitled to the financial asset. It is up to the securities intermediary to take the necessary steps to ensure that it will be able to perform its undertaking. It is, for example, entirely possible that a securities intermediary might make entries in a customer's account reflecting that customer's acquisition of a certain security at a time when the securities intermediary did not itself happen to hold any units of that security. The person from whom the securities intermediary bought the security might have failed to deliver and it might have taken some time to clear up the problem, or there may have been an operational gap in time between the crediting of a customer's account and the receipt of securities from another securities intermediary. The entitlement holder's rights against the securities intermediary do not depend on whether or when the securities intermediary acquired its interests. Subsection (c) is intended to make this point clear. Subsection (c) does not mean that the intermediary is free to create security entitlements without itself holding sufficient financial assets to satisfy its entitlement holders. The duty of a securities intermediary to maintain sufficient assets is governed by Section 8-504 and regulatory law. Subsection (c) is included only to make it clear the question whether a person has acquired a security entitlement does not depend on whether the intermediary has complied with that duty.

4. Part 5 of Article 8 sets out a carefully designed system of rules for the indirect holding system. Persons who hold securities through brokers or custodians have security entitlements that are governed by Part 5, rather than being treated as the direct holders of securities. Subsection (d) specifies the limited circumstance in which a customer who leaves a financial asset with a broker or other securities intermediary has a direct interest in the financial asset, rather than a security entitlement.

The customer can be a direct holder only if the security certificate, or other financial asset, is registered in the name of, payable to the order of, or specially indorsed to the customer, and has not been indorsed by the customer to the securities intermediary or in blank. The distinction between those circumstances where the customer can be treated as direct owner and those where the customer has a security entitlement is essentially the same as the distinction drawn under the federal bankruptcy code between customer name securities and customer property. The distinction does not turn on any form of physical identification or segregation. A customer who delivers certificates to a broker with blank indorsements or stock powers is not a direct holder but has a security entitlement, even though the broker holds those certificates in some form of separate safe-keeping arrangement for that particular customer. The customer remains the direct holder only if there is no indorsement or stock power so that further action by the customer is required to place the certificates in a form where they can be transferred by the broker.

The rule of subsection (d) corresponds to the rule set out in Section 8-301(a)(3) specifying when acquisition of possession of a certificate by a securities intermediary counts as "delivery" to the customer.

5. Subsection (e) is intended to make clear that Part 5 does not apply to an arrangement in which a security is issued representing an interest in underlying assets, as distinguished from arrangements in which the underlying assets are carried in a securities account. A common mechanism by which new financial instruments are devised is that a financial institution that holds some security, financial instrument, or pool thereof, creates interests in that asset or pool which are sold to others. In many such cases, the interests so created will fall within the definition of "security" in Section 8-102(a)(15). If so, then by virtue of subsection (e) of Section 8-501, the relationship between the institution that creates the interests and the persons who hold them is not a security entitlement to which the Part 5 rules apply. Accordingly, an arrangement such as an American depositary receipt facility which creates freely transferable interests in underlying securities will be issuance of a security under Article 8 rather than establishment of a security entitlement to the underlying securities.

The subsection (e) rule can be regarded as an aspect of the definitional rules specifying the meaning of securities account and security entitlement.

Among the key components of the definition of security in Section 8-102(a)(15) are the "transferability" and "divisibility" tests. Securities, in the Article 8 sense, are fungible interests or obligations that are intended to be tradable. The concept of security entitlement under Part 5 is quite different. A security entitlement is the package of rights that a person has against the person's own intermediary with respect to the positions carried in the person's securities account. That package of rights is not, as such, something that is traded. When a customer sells a security that she had held through a securities account, her security entitlement is terminated; when she buys a security that she will hold through her securities account, she acquires a security entitlement. In most cases, settlement of a securities trade will involve termination of one person's security entitlement and acquisition of a security entitlement by another person. That transaction, however, is not a "transfer" of the same entitlement from one person to another. That is not to say that an entitlement holder cannot transfer an interest in her security entitlement as such; granting a security interest in a security entitlement is such a transfer. On the other hand, the nature of a security entitlement is that the intermediary is undertaking duties only to the person identified as the entitlement holder.

Definitional Cross References:

"Financial asset". Section 8-102(a)(9).

"Indorsement". Section 8-102(a)(11).

"Securities intermediary". Section 8-102(a)(14).

"Security". Section 8-102(a)(15).

"Security entitlement". Section 8-102(a)(17).

§ 28-8-502. Assertion of adverse claim against entitlement holder. — An action based on an adverse claim to a financial asset, whether framed in conversion, replevin, constructive trust, equitable lien or other theory, may not be asserted against a person who acquires a security entitlement under section 28-8-501[, Idaho Code], for value and without notice of the adverse claim.

History.

I.C., § 28-8-502, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertion in this section was added by the compiler to conform to the statutory citation style.

Official Comment

1. The section provides investors in the indirect holding system with protection against adverse claims by specifying that no adverse claim can be asserted against a person who acquires a security entitlement under Section 8-501 for value and without notice of the adverse claim. It plays a role in the indirect holding system analogous to the rule of the direct holding system that protected purchasers take free from adverse claims. (Section 8-303).

This section does not use the locution "takes free from adverse claims" because that could be confusing as applied to the indirect holding system. The nature of [the] indirect holding system is that an entitlement holder has an interest in common with others who hold positions in the same financial asset through the same intermediary. Thus, a particular entitlement holder's interest in the financial assets held by its intermediary is necessarily "subject to" the interests of others. See Section 8-503. The rule stated in this section might have been expressed by saying that a person who acquires a security entitlement under Section 8-501 for value and without notice of

adverse claims takes “that security entitlement” free from adverse claims. That formulation has not been used, however, for fear that it would be misinterpreted as suggesting that the person acquires a right to the underlying financial assets that could not be affected by the competing rights of others claiming through common or higher tier intermediaries. A security entitlement is a complex bundle of rights. This section does not deal with the question of what rights are in the bundle. Rather, this section provides that once a person has acquired the bundle, someone else cannot take it away on the basis of assertion that the transaction in which the security entitlement was created involved a violation of the claimant’s rights.

2. Because securities trades are typically settled on a net basis by book-entry movements, it would ordinarily be impossible for anyone to trace the path of any particular security, no matter how the interest of parties who hold through intermediaries is described. Suppose, for example, that S has a 1000 share position in XYZ common stock through an account with a broker, Able & Co. S’s identical twin impersonates S and directs Able to sell the securities. That same day, B places an order with Baker & Co., to buy 1000 shares of XYZ common stock. Later, S discovers the wrongful act and seeks to recover “her shares.” Even if S can show that, at the stage of the trade, her sell order was matched with B’s buy order, that would not suffice to show that “her shares” went to B. Settlement between Able and Baker occurs on a net basis for all trades in XYZ that day; indeed Able’s net position may have been such that it received rather than delivered shares in XYZ through the settlement system.

In the unlikely event that this was the only trade in XYZ common stock executed in the market that day, one could follow the shares from S’s account to B’s account. The plaintiff in an action in conversion or similar legal action to enforce a property interest must show that the defendant has an item of property that belongs to the plaintiff. In this example, B’s security entitlement is not the same item of property that formerly was held by S, it is a new package of rights that B acquired against Baker under Section 8-501. Principles of equitable remedies might, however, provide S with a basis for contending that if the position [property] B received was the traceable product of the wrongful taking of S’s property by S’s twin, a constructive trust should be imposed on B’s property in favor of S. See G.

Palmer, The Law of Restitution § 2.14. Section 8-502 ensures that no such claims can be asserted against a person, such as B in this example, who acquires a security entitlement under Section 8-501 for value and without notice, regardless of what theory of law or equity is used to describe the basis of the assertion of the adverse claim.

In the above example, S would ordinarily have no reason to pursue B unless Able is insolvent and S's claim will not be satisfied in the insolvency proceedings. Because S did not give an entitlement order for the disposition of her security entitlement, Able must recredit her account for the 1000 shares of XYZ common stock. See Section 8-507(b).

3. The following examples illustrate the operation of Section 8-502.

Example 1. Thief steals bearer bonds from Owner. Thief delivers the bonds to Broker for credit to Thief's securities account, thereby acquiring a security entitlement under Section 8-501(b). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Because Thief was himself the wrongdoer, Thief obviously had notice of Owner's adverse claim. Accordingly, Section 8-502 does not preclude Owner from asserting an adverse claim against Thief.

Example 2. Thief steals bearer bonds from Owner. Thief owes a personal debt to Creditor. Creditor has a securities account with Broker. Thief agrees to transfer the bonds to Creditor as security for or in satisfaction of his debt to Creditor. Thief does so by sending the bonds to Broker for credit to Creditor's securities account. Creditor thereby acquires a security entitlement under Section 8-501(b). Under other law, Owner may have a claim to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that Thief misappropriated. Creditor acquired the security entitlement for value, since Creditor acquired it as security for or in satisfaction of Thief's debt to Creditor. See Section 1-201(44) [now 1-204]. If Creditor did not have notice of Owner's claim, Section 8-502 precludes any action by Owner against Creditor, whether framed in constructive trust or other theory. Section 8-105 specifies what counts as notice of an adverse claim.

Example 3. Father, as trustee for Son, holds XYZ Co. shares in a securities account with Able & Co. In violation of his fiduciary duties,

Father sells the XYZ Co. shares and uses the proceeds for personal purposes. Father dies, and his estate is insolvent. Assume — implausibly — that Son is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 precludes any action by Son against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 4. Debtor holds XYZ Co. shares in a securities account with Able & Co. As collateral for a loan from Bank, Debtor grants Bank a security interest in the security entitlement to the XYZ Co. shares. Bank perfects by a method which leaves Debtor with the ability to dispose of the shares. See Section 9-115. In violation of the security agreement, Debtor sells the XYZ Co. shares and absconds with the proceeds. Assume — implausibly — that Bank is able to trace the XYZ Co. shares and show that the "same shares" ended up in Buyer's securities account with Baker & Co. Section 8-502 precludes any action by Bank against Buyer, whether framed in constructive trust or other theory, provided that Buyer acquired the security entitlement for value and without notice of adverse claims.

Example 5. Debtor owns controlling interests in various public companies, including Acme and Ajax. Acme owns 60% of the stock of another public company, Beta. Debtor causes the Beta stock to be pledged to Lending Bank as collateral for Ajax's debt. Acme holds the Beta stock through an account with a securities custodian, C Bank, which in turn holds through Clearing Corporation. Lending Bank is also a Clearing Corporation participant. The pledge of the Beta stock is implemented by Acme instructing C Bank to instruct Clearing Corporation to debit C Bank's account and credit Lending Bank's account. Acme and Ajax both become insolvent. The Beta stock is still valuable. Acme's liquidator asserts that the pledge of the Beta stock for Ajax's debt was wrongful as against Acme and seeks to recover the Beta stock from Lending Bank. Because the pledge was implemented by an outright transfer into Lending Bank's account at Clearing Corporation, Lending Bank acquired a security entitlement to the Beta stock under Section 8-501. Lending Bank acquired the security entitlement for value, since it acquired it as security for a debt. See Section 1-201(44) [now 1-204]. If Lending Bank did not have notice of Acme's

claim, Section 8-502 will preclude any action by Acme against Lending Bank, whether framed in constructive trust or other theory.

4. Although this section protects entitlement holders against adverse claims, it does not protect them against the risk that their securities intermediary will not itself have sufficient financial assets to satisfy the claims of all of its entitlement holders. Suppose that Customer A holds 1000 shares of XYZ Co. stock in an account with her broker, Able & Co. Able in turn holds 1000 shares of XYZ Co. through its account with Clearing Corporation, but has no other positions in XYZ Co. shares, either for other customers or for its own proprietary account. Customer B places an order with Able for the purchase of 1000 shares of XYZ Co. stock, and pays the purchase price. Able credits B's account with a 1000 share position in XYZ Co. stock, but Able does not itself buy any additional XYZ Co. shares. Able fails, having only 1000 shares to satisfy the claims of A and B. Unless other insolvency law establishes a different distributional rule, A and B would share the 1000 shares held by Able pro rata, without regard to the time that their respective entitlements were established. See Section 8-503(b). Section 8-502 protects entitlement holders, such as A and B, against adverse claimants. In this case, however, the problem that A and B face is not that someone is trying to take away their entitlements, but that the entitlements are not worth what they thought. The only role that Section 8-502 plays in this case is to preclude any assertion that A has some form of claim against B by virtue of the fact that Able's establishment of an entitlement in favor of B diluted A's rights to the limited assets held by Able.

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1).

"Financial asset". Section 8-102(a)(9).

"Notice of adverse claim". Section 8-105.

"Security entitlement". Section 8-102(a)(17).

"Value". Sections 1-204 & 8-116.

§ 28-8-503. Property interest of entitlement holder in financial asset held by securities intermediary. — (1) To the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in section 28-8-511[, Idaho Code].

(2) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) of this section is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.

(3) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) of this section may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under sections 28-8-505 through 28-8-508[, Idaho Code].

(4) An entitlement holder's property interest with respect to a particular financial asset under subsection (1) of this section may be enforced against a purchaser of the financial asset or interest therein only if:

(a) Insolvency proceedings have been initiated by or against the securities intermediary;

(b) The securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitlements of all of its entitlement holders to that financial asset;

(c) The securities intermediary violated its obligations under section 28-8-504[, Idaho Code,] by transferring the financial asset or interest therein to the purchaser; and

(d) The purchaser is not protected under subsection (5) of this section.

The trustee or other liquidator, acting on behalf of all entitlement holders having security entitlements with respect to a particular financial asset, may recover the financial asset, or interest therein, from the purchaser. If the trustee or other liquidator elects not to pursue that right, an entitlement holder whose security entitlement remains unsatisfied has the right to recover its interest in the financial asset from the purchaser.

(5) An action based on the entitlement holder's property interest with respect to a particular financial asset under subsection (1) of this section, whether framed in conversion, replevin, constructive trust, equitable lien or other theory, may not be asserted against any purchaser of a financial asset or interest therein who gives value, obtains control, and does not act in collusion with the securities intermediary in violating the securities intermediary's obligations under section 28-8-504[, Idaho Code].

History.

I.C., § 28-8-503, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions throughout this section were added by the compiler to conform to the statutory citation style.

Official Comment

1. This section specifies the sense in which a security entitlement is an interest in the property held by the securities intermediary. It expresses the ordinary understanding that securities that a firm holds for its customers are not general assets of the firm subject to the claims of creditors. Since securities intermediaries generally do not segregate securities in such fashion that one could identify particular securities as the ones held for customers, it would not be realistic for this section to state that "customers' securities" are not subject to creditors' claims. Rather subsection (a) provides that to the extent necessary to satisfy all customer claims, all units of that security held by the firm are held for the entitlement holders', are not property of the securities intermediary, and are not subject to creditors' claims, except as otherwise provided in Section 8-511.

An entitlement holder's property interest under this section is an interest with respect to a specific issue of securities or financial assets. For example, customers of a firm who have positions in XYZ common stock have security entitlements with respect to the XYZ common stock held by the intermediary, while other customers who have positions in ABC common stock have security entitlements with respect to the ABC common stock held by the intermediary.

Subsection (b) makes clear that the property interest described in subsection (a) is an interest held in common by all entitlement holders who have entitlements to a particular security or other financial asset. Temporal factors are irrelevant. One entitlement holder cannot claim that its rights to the assets held by the intermediary are superior to the rights of another entitlement holder by virtue of having acquired those rights before, or after, the other entitlement holder. Nor does it matter whether the intermediary had sufficient assets to satisfy all entitlement holders' claims at one point, but no longer does. Rather, all entitlement holders have a pro rata interest in whatever positions in that financial asset the intermediary holds.

Although this section describes the property interest of entitlement holders in the assets held by the intermediary, it does not necessarily determine how property held by a failed intermediary will be distributed in insolvency proceedings. If the intermediary fails and its affairs are being administered in an insolvency proceeding, the applicable insolvency law governs how the various parties having claims against the firm are treated. For example, the distributional rules for stockbroker liquidation proceedings under the Bankruptcy Code and Securities Investor Protection Act ("SIPA") provide that all customer property is distributed pro rata among all customers in proportion to the dollar value of their total positions, rather than dividing the property on an issue by issue basis. For intermediaries that are not subject to the Bankruptcy Code and SIPA, other insolvency law would determine what distributional rule is applied.

2. Although this section recognizes that the entitlement holders of a securities intermediary have a property interest in the financial assets held by the intermediary, the incidents of this property interest are established by the rules of Article 8, not by common law property concepts. The traditional Article 8 rules on certificated securities were based on the idea that a paper certificate could be regarded as a nearly complete reification of

the underlying right. The rules on transfer and the consequences of wrongful transfer could then be written using the same basic concepts as the rules for physical chattels. A person's claim of ownership of a certificated security is a right to a specific identifiable physical object, and that right can be asserted against any person who ends up in possession of that physical certificate, unless cut off by the rules protecting purchasers for value without notice. Those concepts do not work for the indirect holding system. A security entitlement is not a claim to a specific identifiable thing; it is a package of rights and interests that a person has against the person's securities intermediary and the property held by the intermediary. The idea that discrete objects might be traced through the hands of different persons has no place in the Revised Article 8 rules for the indirect holding system. The fundamental principles of the indirect holding system rules are that an entitlement holder's own intermediary has the obligation to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the financial asset, and that the entitlement holder can look only to that intermediary for performance of the obligations. The entitlement holder cannot assert rights directly against other persons, such as other intermediaries through whom the intermediary holds the positions, or third parties to whom the intermediary may have wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the wrongdoing. Subsections (c) through (e) reflect these fundamental principles.

Subsection (c) provides that an entitlement holder's property interest can be enforced against the intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508. These are the provisions that set out the duty of an intermediary to see to it that the entitlement holder receives all of the economic and corporate rights that comprise the security. If the intermediary is in insolvency proceedings and can no longer perform in accordance with the ordinary Part 5 rules, the applicable insolvency law will determine how the intermediary's assets are to be distributed.

Subsections (d) and (e) specify the limited circumstances in which an entitlement holder's property interest can be asserted against a third person to whom the intermediary transferred a financial asset that was subject to the entitlement holder's claim when held by the intermediary. Subsection

(d) provides that the property interest of entitlement holders cannot be asserted against any transferee except in the circumstances therein specified. So long as the intermediary is solvent, the entitlement holders must look to the intermediary to satisfy their claims. If the intermediary does not hold financial assets corresponding to the entitlement holders' claims, the intermediary has the duty to acquire them. See Section 8-504. Thus, paragraphs (1), (2), and (3) of subsection (d) specify that the only occasion in which the entitlement holders can pursue transferees is when the intermediary is unable to perform its obligation, and the transfer to the transferee was a violation of those obligations. Even in that case, a transferee who gave value and obtained control is protected by virtue of the rule in subsection (e), unless the transferee acted in collusion with the intermediary.

Subsections (d) and (e) have the effect of protecting transferees from an intermediary against adverse claims arising out of assertions by the intermediary's entitlement holders that the intermediary acted wrongfully in transferring the financial assets. These rules, however, operate in a slightly different fashion than traditional adverse claim cut-off rules. Rather than specifying that a certain class of transferee takes free from all claims, subsections (d) and (e) specify the circumstances in which this particular form of claim can be asserted against a transferee. Revised Article 8 also contains general adverse claim cut-off rules for the indirect holding system. See Sections 8-502 and 8-510. The rule of subsections (d) and (e) takes precedence over the general cut-off rules of those sections, because Section 8-503 itself defines and sets limits on the assertion of the property interest of entitlement holders. Thus, the question whether entitlement holders' property interest can be asserted as an adverse claim against a transferee from the intermediary is governed by the collusion test of Section 8-503(e), rather than by the "without notice" test of Sections 8-502 and 8-510.

3. The limitations that subsections (c) through (e) place on the ability of customers of a failed intermediary to recover securities or other financial assets from transferees are consistent with the fundamental policies of investor protection that underlie this Article and other bodies of law governing the securities business. The commercial law rules for the securities holding and transfer system must be assessed from the forward-looking perspective of their impact on the vast number of transactions in

which no wrongful conduct occurred or will occur, rather than from the *post hoc* perspective of what rule might be most advantageous to a particular class of persons in litigation that might arise out of the occasional case in which someone has acted wrongfully. Although one can devise hypothetical scenarios where particular customers might find it advantageous to be able to assert rights against someone other than the customers' own intermediary, commercial law rules that permitted customers to do so would impair rather than promote the interest of investors and the safe and efficient operation of the clearance and settlement system. Suppose, for example, that Intermediary A transfers securities to B, that Intermediary A acted wrongfully as against its customers in so doing, and that after the transaction Intermediary A did not have sufficient securities to satisfy its obligations to its entitlement holders. Viewed solely from the standpoint of the customers of Intermediary A, it would seem that permitting the property to be recovered from B, would be good for investors. That, however, is not the case. B may itself be an intermediary with its own customers, or may be some other institution through which individuals invest, such as a pension fund or investment company. There is no reason to think that rules permitting customers of an intermediary to trace and recover securities that their intermediary wrongfully transferred work to the advantage of investors in general. To the contrary, application of such rules would often merely shift losses from one set of investors to another. The uncertainties that would result from rules permitting such recoveries would work to the disadvantage of all participants in the securities markets.

The use of the collusion test in Section 8-503(e) furthers the interests of investors generally in the sound and efficient operation of the securities holding and settlement system. The effect of the choice of this standard is that customers of a failed intermediary must show that the transferee from whom they seek to recover was affirmatively engaged in wrongful conduct, rather than casting on the transferee any burden of showing that the transferee had no awareness of wrongful conduct by the failed intermediary. The rule of Section 8-503(e) is based on the long-standing policy that it is undesirable to impose upon purchasers of securities any duty to investigate whether their sellers may be acting wrongfully.

Rather than imposing duties to investigate, the general policy of the commercial law of the securities holding and transfer system has been to

eliminate legal rules that might induce participants to conduct investigations of the authority of persons transferring securities on behalf of others for fear that they might be held liable for participating in a wrongful transfer. The rules in Part 4 of Article 8 concerning transfers by fiduciaries provide a good example. Under *Lowry v. Commercial & Farmers' Bank*, 15 F. Cas. 1040 (C.C.D. Md. 1848) (No. 8551), an issuer could be held liable for wrongful transfer if it registered transfer of securities by a fiduciary under circumstances where it had any reason to believe that the fiduciary may have been acting improperly. In one sense that seems to be advantageous for beneficiaries who might be harmed by wrongful conduct by fiduciaries. The consequence of the *Lowry* rule, however, was that in order to protect against risk of such liability, issuers developed the practice of requiring extensive documentation for fiduciary stock transfers, making such transfers cumbersome and time consuming. Accordingly, the rules in Part 4 of Article 8, and in the prior fiduciary transfer statutes, were designed to discourage transfer agents from conducting investigations into the rightfulness of transfers by fiduciaries.

The rules of Revised Article 8 implement for the indirect holding system the same policies that the rules on protected purchasers and registration of transfer adopt for the direct holding system. A securities intermediary is, by definition, a person who is holding securities on behalf of other persons. There is nothing unusual or suspicious about a transaction in which a securities intermediary sells securities that it was holding for its customers. That is exactly what securities intermediaries are in business to do. The interests of customers of securities intermediaries would not be served by a rule that required counterparties to transfers from securities intermediaries to investigate whether the intermediary was acting wrongfully against its customers. Quite the contrary, such a rule would impair the ability of securities intermediaries to perform the function that customers want.

The rules of Section 8-503(c) through (e) apply to transferees generally, including pledgees. The reasons for treating pledgees in the same fashion as other transferees are discussed in the Comments to Section 8-511. The statement in subsection (a) that an intermediary holds financial assets for customers and not as its own property does not, of course, mean that the intermediary lacks power to transfer the financial assets to others. For example, although Article 9 provides that for a security interest to attach the

debtor must have "rights" in the collateral, see Section 9-203, the fact that an intermediary is holding a financial asset in a form that permits ready transfer means that it has such rights, even if the intermediary is acting wrongfully against its entitlement holders in granting the security interest. The question whether the secured party takes subject to the entitlement holder's claim in such a case is governed by Section 8-511, which is an application to secured transactions of the general principles expressed in subsections (d) and (e) of this section.

Definitional Cross References:

"Control". Section 8-106.

"Entitlement holder". Section 8-102(a)(7).

"Financial asset". Section 8-102(a)(9).

"Insolvency proceedings". Section 1-201(22).

"Purchaser". Sections 1-201(30) & 8-116.

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

"Value". Sections 1-204 & 8-116.

§ 28-8-504. Duty of securities intermediary to maintain financial asset.

— (1) A securities intermediary shall promptly obtain and thereafter maintain a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favor of its entitlement holders with respect to that financial asset. The securities intermediary may maintain those financial assets directly or through one (1) or more other securities intermediaries.

(2) Except to the extent otherwise agreed by its entitlement holder, a securities intermediary may not grant any security interests in a financial asset it is obligated to maintain pursuant to subsection (1) of this section.

(3) A securities intermediary satisfies the duty in subsection (1) of this section if:

(a) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or

(b) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset.

(4) This section does not apply to a clearing corporation that is itself the obligor of an option or similar obligation to which its entitlement holders have security entitlements.

History.

I.C., § 28-8-504, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. This section expresses one of the core elements of the relationships for which the Part 5 rules were designed, to wit, that a securities intermediary undertakes to hold financial assets corresponding to the security entitlements of its entitlement holders. The locution "shall promptly obtain and shall thereafter maintain" is taken from the corresponding regulation under federal securities law, 17 C.F.R. § 240.15c3-3. This section recognizes the reality that as the securities business is conducted today, it is

not possible to identify particular securities as belonging to customers as distinguished from other particular securities that are the firm's own property. Securities firms typically keep all securities in fungible form, and may maintain their inventory of a particular security in various locations and forms, including physical securities held in vaults or in transit to transfer agents, and book entry positions at one or more clearing corporations. Accordingly, this section states that a securities intermediary shall maintain a quantity of financial assets corresponding to the aggregate of all security entitlements it has established. The last sentence of subsection (a) provides explicitly that the securities intermediary may hold directly or indirectly. That point is implicit in the use of the term "financial asset," inasmuch as Section 8-102(a)(9) provides that the term "financial asset" may refer either to the underlying asset or the means by which it is held, including both security certificates and security entitlements.

2. Subsection (b) states explicitly a point that is implicit in the notion that a securities intermediary must maintain financial assets corresponding to the security entitlements of its entitlement holders, to wit, that it is wrongful for a securities intermediary to grant security interests in positions that it needs to satisfy customers' claims, except as authorized by the customers. This statement does not determine the rights of a secured party to whom a securities intermediary wrongfully grants a security interest; that issue is governed by Sections 8-503 and 8-511.

Margin accounts are common examples of arrangements in which an entitlement holder authorizes the securities intermediary to grant security interests in the positions held for the entitlement holder. Securities firms commonly obtain the funds needed to provide margin loans to their customers by "rehypothecating" the customers' securities. In order to facilitate rehypothecation, agreements between margin customers and their brokers commonly authorize the broker to commingle securities of all margin customers for rehypothecation to the lender who provides the financing. Brokers commonly rehypothecate customer securities having a value somewhat greater than the amount of the loan made to the customer, since the lenders who provide the necessary financing to the broker need some cushion of protection against the risk of decline in the value of the rehypothecated securities. The extent and manner in which a firm may rehypothecate customers' securities are determined by the agreement

between the intermediary and the entitlement holder and by applicable regulatory law. Current regulations under the federal securities laws require that brokers obtain the explicit consent of customers before pledging customer securities or commingling different customers' securities for pledge. Federal regulations also limit the extent to which a broker may rehypothecate customer securities to 110% of the aggregate amount of the borrowings of all customers.

3. The statement in this section that an intermediary must obtain and maintain financial assets corresponding to the aggregate of all security entitlements it has established is intended only to capture the general point that one of the key elements that distinguishes securities accounts from other relationships, such as deposit accounts, is that the intermediary undertakes to maintain a direct correspondence between the positions it holds and the claims of its customers. This section is not intended as a detailed specification of precisely how the intermediary is to perform this duty, nor whether there may be special circumstances in which an intermediary's general duty is excused. Accordingly, the general statement of the duties of a securities intermediary in this and the following sections is supplemented by two other provisions. First, each of Sections 8-504 through 8-508 contains an "agreement/due care" provision. Second, Section 8-509 sets out general qualifications on the duties stated in these sections, including the important point that compliance with corresponding regulatory provisions constitutes compliance with the Article 8 duties.

4. The "agreement/due care" provision in subsection (c) of this section is necessary to provide sufficient flexibility to accommodate the general duty stated in subsection (a) to the wide variety of circumstances that may be encountered in the modern securities holding system. For the most common forms of publicly traded securities, the modern depository-based indirect holding system has made the likelihood of an actual loss of securities remote, though correctable errors in accounting or temporary interruptions of data processing facilities may occur. Indeed, one of the reasons for the evolution of book-entry systems is to eliminate the risk of loss or destruction of physical certificates. There are, however, some forms of securities and other financial assets which must still be held in physical certificated form, with the attendant risk of loss or destruction. Risk of loss or delay may be a more significant consideration in connection with foreign

securities. An American securities intermediary may well be willing to hold a foreign security in a securities account for its customer, but the intermediary may have relatively little choice of or control over foreign intermediaries through which the security must in turn be held. Accordingly, it is common for American securities intermediaries to disclaim responsibility for custodial risk of holding through foreign intermediaries.

Subsection (c)(1) provides that a securities intermediary satisfies the duty stated in subsection (a) if the intermediary acts with respect to that duty in accordance with the agreement between the intermediary and the entitlement holder. Subsection (c)(2) provides that if there is no agreement on the matter, the intermediary satisfies the subsection (a) duty if the intermediary exercises due care in accordance with reasonable commercial standards to obtain and maintain the financial asset in question. This formulation does not state that the intermediary has a universally applicable statutory duty of due care. Section 1-102(3) provides that statutory duties of due care cannot be disclaimed by agreement, but the "agreement/due care" formula contemplates that there may be particular circumstances where the parties do not wish to create a specific duty of due care, for example, with respect to foreign securities. Under subsection (c)(1), compliance with the agreement constitutes satisfaction of the subsection (a) duty, whether or not the agreement provides that the intermediary will exercise due care.

In each of the sections where the "agreement/due care" formula is used, it provides that entering into an agreement and performing in accordance with that agreement is a method by which the securities intermediary may satisfy the statutory duty stated in that section. Accordingly, the general obligation of good faith performance of statutory and contract duties, see Sections 1-203 and 8-102(a)(10), would apply to such an agreement. It would not be consistent with the obligation of good faith performance for an agreement to purport to establish the usual sort of arrangement between an intermediary and entitlement holder, yet disclaim altogether one of the basic elements that define that relationship. For example, an agreement stating that an intermediary assumes no responsibilities whatsoever for the safekeeping any of the entitlement holder's securities positions would not be consistent with good faith performance of the intermediary's duty to

obtain and maintain financial assets corresponding to the entitlement holder's security entitlements.

To the extent that no agreement under subsection (c)(1) has specified the details of the intermediary's performance of the subsection (a) duty, subsection (c)(2) provides that the intermediary satisfies that duty if it exercises due care in accordance with reasonable commercial standards. The duty of care includes both care in the intermediary's own operations and care in the selection of other intermediaries through whom the intermediary holds the assets in question. The statement of the obligation of due care is meant to incorporate the principles of the common law under which the specific actions or precautions necessary to meet the obligation of care are determined by such factors as the nature and value of the property, the customs and practices of the business, and the like.

5. This section necessarily states the duty of a securities intermediary to obtain and maintain financial assets only at the very general and abstract level. For the most part, these matters are specified in great detail by regulatory law. Broker-dealers registered under the federal securities laws are subject to detailed regulation concerning the safeguarding of customer securities. See 17 C.F.R. § 240.15c3-3. Section 8-509(a) provides explicitly that if a securities intermediary complies with such regulatory law, that constitutes compliance with Section 8-504. In certain circumstances, these rules permit a firm to be in a position where it temporarily lacks a sufficient quantity of financial assets to satisfy all customer claims. For example, if another firm has failed to make a delivery to the firm in settlement of a trade, the firm is permitted a certain period of time to clear up the problem before it is obligated to obtain the necessary securities from some other source.

6. Subsection (d) is intended to recognize that there are some circumstances, where the duty to maintain a sufficient quantity of financial assets does not apply because the intermediary is not holding anything on behalf of others. For example, the Options Clearing Corporation is treated as a "securities intermediary" under this Article, although it does not itself hold options on behalf of its participants. Rather, it becomes the issuer of the options, by virtue of guaranteeing the obligations of participants in the clearing corporation who have written or purchased the options cleared through it. See Section 8-103(e). Accordingly, the general duty of an

intermediary under subsection (a) does not apply, nor would other provisions of Part 5 that depend upon the existence of a requirement that the securities intermediary hold financial assets, such as Sections 8-503 and 8-508.

Definitional Cross References:

"Agreement". Section 1-201(3).

"Clearing corporation". Section 8-102(a)(5).

"Entitlement holder". Section 8-102(a)(7).

"Financial asset". Section 8-102(a)(9).

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

§ 28-8-505. Duty of securities intermediary with respect to payments and distributions. — (1) A securities intermediary shall take action to obtain a payment or distribution made by the issuer of a financial asset. A securities intermediary satisfies the duty if:

(a) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or (b) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to attempt to obtain the payment or distribution.

(2) A securities intermediary is obligated to its entitlement holder for a payment or distribution made by the issuer of a financial asset if the payment or distribution is received by the securities intermediary.

History.

I.C., § 28-8-505, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. One of the core elements of the securities account relationships for which the Part 5 rules were designed is that the securities intermediary passes through to the entitlement holders the economic benefit of ownership of the financial asset, such as payments and distributions made by the issuer. Subsection (a) expresses the ordinary understanding that a securities intermediary will take appropriate action to see to it that any payments or distributions made by the issuer are received. One of the main reasons that investors make use of securities intermediaries is to obtain the services of a professional in performing the record-keeping and other functions necessary to ensure that payments and other distributions are received.

2. Subsection (a) incorporates the same “agreement/due care” formula as the other provisions of Part 5 dealing with the duties of a securities intermediary. See Comment 4 to Section 8-504. This formulation permits the parties to specify by agreement what action, if any, the intermediary is to take with respect to the duty to obtain payments and distributions. In the absence of specification by agreement, the intermediary satisfies the duty if

the intermediary exercises due care in accordance with reasonable commercial standards. The provisions of Section 8-509 also apply to the Section 8-505 duty, so that compliance with applicable regulatory requirements constitutes compliance with the Section 8-505 duty.

3. Subsection (b) provides that a securities intermediary is obligated to its entitlement holder for those payments or distributions made by the issuer that are in fact received by the intermediary. It does not deal with the details of the time and manner of payment. Moreover, as with any other monetary obligation, the obligation to pay may be subject to other rights of the obligor, by way of set-off counterclaim or the like. Section 8-509(c) makes this point explicit.

Definitional Cross References: “Agreement”. Section 1-201(3).

“Entitlement holder”. Section 8-102(a)(7).

“Financial asset”. Section 8-102(a)(9).

“Securities intermediary”. Section 8-102(a)(14).

“Security entitlement”. Section 8-102(a)(17).

§ 28-8-506. Duty of securities intermediary to exercise rights as directed by entitlement holder. — A securities intermediary shall exercise rights with respect to a financial asset if directed to do so by an entitlement holder. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or (2) In the absence of agreement, the securities intermediary either places the entitlement holder in a position to exercise the rights directly or exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

History.

I.C., § 28-8-506, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. Another of the core elements of the securities account relationships for which the Part 5 rules were designed is that although the intermediary may, by virtue of the structure of the indirect holding system, be the party who has the power to exercise the corporate and other rights that come from holding the security, the intermediary exercises these powers as representative of the entitlement holder rather than at its own discretion. This characteristic is one of the things that distinguishes a securities account from other arrangements where one person holds securities "on behalf of" another, such as the relationship between a mutual fund and its shareholders or a trustee and its beneficiary.

2. The fact that the intermediary exercises the rights of security holding as representative of the entitlement holder does not, of course, preclude the entitlement holder from conferring discretionary authority upon the intermediary. Arrangements are not uncommon in which investors do not wish to have their intermediaries forward proxy materials or other information. Thus, this section provides that the intermediary shall exercise corporate and other rights "if directed to do so" by the entitlement holder. Moreover, as with the other Part 5 duties, the "agreement/due care"

formulation is used in stating how the intermediary is to perform this duty. This section also provides that the intermediary satisfies the duty if it places the entitlement holder in a position to exercise the rights directly. This is to take account of the fact that some of the rights attendant upon ownership of the security, such as rights to bring derivative and other litigation, are far removed from the matters that intermediaries are expected to perform.

3. This section, and the two that follow, deal with the aspects of securities holding that are related to investment decisions. For example, one of the rights of holding a particular security that would fall within the purview of this section would be the right to exercise a conversion right for a convertible security. It is quite common for investors to confer discretionary authority upon another person, such as an investment adviser, with respect to these rights and other investment decisions. Because this section, and the other sections of Part 5, all specify that a securities intermediary satisfies the Part 5 duties if it acts in accordance with the entitlement holder's agreement, there is no inconsistency between the statement of duties of a securities intermediary and these common arrangements.

4. Section 8-509 also applies to the Section 8-506 duty, so that compliance with applicable regulatory requirements constitutes compliance with this duty. This is quite important in this context, since the federal securities laws establish a comprehensive system of regulation of the distribution of proxy materials and exercise of voting rights with respect to securities held through brokers and other intermediaries. By virtue of Section 8-509(a), compliance with such regulatory requirement constitutes compliance with the Section 8-506 duty.

Definitional Cross References: "Agreement". Section 1-201(3).

"Entitlement holder". Section 8-102(a)(7).

"Financial asset". Section 8-102(a)(9).

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

§ 28-8-507. Duty of securities intermediary to comply with entitlement order. — (1) A securities intermediary shall comply with an entitlement order if the entitlement order is originated by the appropriate person, the securities intermediary has had reasonable opportunity to assure itself that the entitlement order is genuine and authorized, and the securities intermediary has had reasonable opportunity to comply with the entitlement order. A securities intermediary satisfies the duty if:

(a) The securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or (b) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order.

(2) If a securities intermediary transfers a financial asset pursuant to an ineffective entitlement order, the securities intermediary shall reestablish a security entitlement in favor of the person entitled to it, and pay or credit any payments or distributions that the person did not receive as a result of the wrongful transfer. If the securities intermediary does not reestablish a security entitlement, the securities intermediary is liable to the entitlement holder for damages.

History.

I.C., § 28-8-507, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. Subsection (a) of this section states another aspect of duties of securities intermediaries that make up security entitlements — the securities intermediary's duty to comply with entitlement orders. One of the main reasons for holding securities through securities intermediaries is to enable rapid transfer in settlement of trades. Thus the right to have one's orders for disposition of the security entitlement honored is an inherent part of the relationship. Subsection (b) states the correlative liability of a securities intermediary for transferring a financial asset from an entitlement holder's account pursuant to an entitlement order that was not effective.

2. The duty to comply with entitlement orders is subject to several qualifications. The intermediary has a duty only with respect to an entitlement order that is in fact originated by the appropriate person. Moreover, the intermediary has a duty only if it has had reasonable opportunity to assure itself that the order is genuine and authorized, and reasonable opportunity to comply with the order. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries, and the rules of Section 8-509 apply to the Section 8-507 duty.

3. Appropriate person is defined in Section 8-107. In the usual case, the appropriate person is the entitlement holder, see Section 8-107(a)(3). Entitlement holder is defined in Section 8-102(a)(7) as the person "identified in the records of a securities intermediary as the person having a security entitlement." Thus, the general rule is that an intermediary's duty with respect to entitlement orders runs only to the person with whom the intermediary has established a relationship. One of the basic principles of the indirect holding system is that securities intermediaries owe duties only to their own customers. See also Section 8-115. The only situation in which a securities intermediary has a duty to comply with entitlement orders originated by a person other than the person with whom the intermediary established a relationship is covered by Section 8-107(a)(4) and (a)(5), which provide that the term "appropriate person" includes the successor or personal representative of a decedent, or the custodian or guardian of a person who lacks capacity. If the entitlement holder is competent, another person does not fall within the defined term "appropriate person" merely by virtue of having power to act as an agent for the entitlement holder. Thus, an intermediary is not required to determine at its peril whether a person who purports to be authorized to act for an entitlement holder is in fact authorized to do so. If an entitlement holder wishes to be able to act through agents, the entitlement holder can establish appropriate arrangements in advance with the securities intermediary.

One important application of this principle is that if an entitlement holder grants a security interest in its security entitlements to a third-party lender, the intermediary owes no duties to the secured party, unless the intermediary has entered into a "control" agreement in which it agrees to act on entitlement orders originated by the secured party. See Section 8-106.

Even though the security agreement or some other document may give the secured party authority to act as agent for the debtor, that would not make the secured party an "appropriate person" to whom the security intermediary owes duties. If the entitlement holder and securities intermediary have agreed to such a control arrangement, then the intermediary's action in following instructions from the secured party would satisfy the subsection (a) duty. Although an agent, such as the secured party in this example, is not an "appropriate person," an entitlement order is "effective" if originated by an authorized person. See Section 8-107(a) and (b). Moreover, Section 8-507(a) provides that the intermediary satisfies its duty if it acts in accordance with the entitlement holder's agreement.

4. Subsection (b) provides that an intermediary is liable for a wrongful transfer if the entitlement order was "ineffective." Section 8-107 specifies whether an entitlement order is effective. An "effective entitlement order" is different from an "entitlement order originated by an appropriate person." An entitlement order is effective under Section 8-107(b) if it is made by the appropriate person, or by a person who has power to act for the appropriate person under the law of agency, or if the appropriate person has ratified the entitlement order or is precluded from denying its effectiveness. Thus, although a securities intermediary does not have a duty to act on an entitlement order originated by the entitlement holder's agent, the intermediary is not liable for wrongful transfer if it does so.

Subsection (b), together with Section 8-107, has the effect of leaving to other law most of the questions of the sort dealt with by Article 4A for wire transfers of funds, such as allocation between the securities intermediary and the entitlement holder of the risk of fraudulent entitlement orders.

5. The term entitlement order does not cover all directions that a customer might give a broker concerning securities held through the broker. Article 8 is not a codification of all of the law of customers and stockbrokers. Article 8 deals with the settlement of securities trades, not the trades. The term entitlement order does not refer to instructions to a broker to make trades, that is, enter into contracts for the purchase or sale of securities. Rather, the entitlement order is the mechanism of transfer for securities held through intermediaries, just as indorsements and instructions are the mechanism for securities held directly. In the ordinary case the

customer's direction to the broker to deliver the securities at settlement is implicit in the customer's instruction to the broker to sell. The distinction is, however, significant in that this section has no application to the relationship between the customer and broker with respect to the trade itself. For example, assertions by a customer that it was damaged by a broker's failure to execute a trading order sufficiently rapidly or in the proper manner are not governed by this Article.

Definitional Cross References: "Agreement". Section 1-201(3).

"Appropriate person". Section 8-107.

"Effective". Section 8-107.

"Entitlement holder". Section 8-102(a)(7).

"Entitlement order". Section 8-102(a)(8).

"Financial asset". Section 8-102(a)(9).

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

§ 28-8-508. Duty of securities intermediary to change entitlement holder's position to other form of security holding. — A securities intermediary shall act at the direction of an entitlement holder to change a security entitlement into another available form of holding for which the entitlement holder is eligible, or to cause the financial asset to be transferred to a securities account of the entitlement holder with another securities intermediary. A securities intermediary satisfies the duty if:

(1) The securities intermediary acts as agreed upon by the entitlement holder and the securities intermediary; or (2) In the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

History.

I.C., § 28-8-508, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. This section states another aspect of the duties of securities intermediaries that make up security entitlements — the obligation of the securities intermediary to change an entitlement holder's position into any other form of holding for which the entitlement holder is eligible or to transfer the entitlement holder's position to an account at another intermediary. This section does not state unconditionally that the securities intermediary is obligated to turn over a certificate to the customer or to cause the customer to be registered on the books of the issuer, because the customer may not be eligible to hold the security directly. For example, municipal bonds are now commonly issued in "book-entry only" form, in which the only entity that the issuer will register on its own books is a depository.

If security certificates in registered form are issued for the security, and individuals are eligible to have the security registered in their own name, the entitlement holder can request that the intermediary deliver or cause to be delivered to the entitlement holder a certificate registered in the name of the entitlement holder or a certificate indorsed in blank or specially indorsed

to the entitlement holder. If security certificates in bearer form are issued for the security, the entitlement holder can request that the intermediary deliver or cause to be delivered a certificate in bearer form. If the security can be held by individuals directly in uncertificated form, the entitlement holder can request that the security be registered in its name. The specification of this duty does not determine the pricing terms of the agreement in which the duty arises.

2. The same "agreement/due care" formula is used in this section as in the other Part 5 sections on the duties of intermediaries. So too, the rules of Section 8-509 apply to the Section 8-508 duty.

Definitional Cross References: "Agreement". Section 1-201(3).

"Entitlement holder". Section 8-102(a)(7).

"Financial asset". Section 8-102(a)(9).

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

§ 28-8-509. Specification of duties of securities intermediary by other statute or regulation — Manner of performance of duties of securities intermediary and exercise of rights of entitlement holder.

— (1) If the substance of a duty imposed upon a securities intermediary by sections 28-8-504 through 28-8-508[, Idaho Code,] is the subject of other statute, regulation or rule, compliance with that statute, regulation or rule satisfies the duty.

(2) To the extent that specific standards for the performance of the duties of a securities intermediary or the exercise of the rights of an entitlement holder are not specified by other statute, regulation, or rule or by agreement between the securities intermediary and entitlement holder, the securities intermediary shall perform its duties and the entitlement holder shall exercise its rights in a commercially reasonable manner.

(3) The obligation of a securities intermediary to perform the duties imposed by sections 28-8-504 through 28-8-508[, Idaho Code,] is subject to: (a) Rights of the securities intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and (b) Rights of the securities intermediary under other law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

(4) Sections 28-8-504 through 28-8-508[, Idaho Code,] do not require a securities intermediary to take any action that is prohibited by other statute, regulation, or rule.

History.

I.C., § 28-8-509, as added by 1995, ch. 272, § 2, p. 873.

STATUTORY NOTES

Compiler’s Notes.

The bracketed insertions in subsection (1), the introductory paragraph in subsection (3), and subsection (4) were added by the compiler to conform to the statutory citation style.

Official Comment

This Article is not a comprehensive statement of the law governing the relationship between broker-dealers or other securities intermediaries and their customers. Most of the law governing that relationship is the common law of contract and agency, supplemented or supplanted by regulatory law. This Article deals only with the most basic commercial/property law principles governing the relationship. Although Sections 8-504 through 8-508 specify certain duties of securities intermediaries to entitlement holders, the point of these sections is to identify what it means to have a security entitlement, not to specify the details of performance of these duties.

For many intermediaries, regulatory law specifies in great detail the intermediary's obligations on such matters as safekeeping of customer property, distribution of proxy materials, and the like. To avoid any conflict between the general statement of duties in this Article and the specific statement of intermediaries' obligations in such regulatory schemes, subsection (a) provides that compliance with applicable regulation constitutes compliance with the duties specified in Sections 8-504 through 8-508.

Definitional Cross References: "Agreement". Section 1-201(3).

"Entitlement holder". Section 8-102(a)(7).

"Securities intermediary". Section 8-102(a)(14).

"Security agreement". Section 9-105(1)(1).

"Security interest". Section 1-201(35).

§ 28-8-510. Rights of purchaser of security entitlement from entitlement holder. — (1) In a case not covered by the priority rules in chapter 9, title 28, Idaho Code, or the rules stated in subsection (3) of this section, an action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.

(2) If an adverse claim could not have been asserted against an entitlement holder under section 28-8-502[, Idaho Code], the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(3) In a case not covered by the priority rules in chapter 9, title 28, Idaho Code, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Except as otherwise provided in subsection (4) of this section, purchasers who have control rank according to priority in time of:

(a) The purchaser's becoming the person for whom the securities account, in which the security entitlement is carried, is maintained, if the purchaser obtained control under section 28-8-106(4)(a)[, Idaho Code];

(b) The securities intermediary's agreement to comply with the purchaser's entitlement orders with respect to security entitlements carried or to be carried in the securities account in which the security entitlement is carried, if the purchaser obtained control under section 28-8-106(4)(b)[, Idaho Code]; or

(c) If the purchaser obtained control through another person under section 28-8-106(4)(c)[, Idaho Code], the time on which priority would be based under this subsection if the other person were the secured party.

(4) A securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities

intermediary.

History.

I.C., § 28-8-510, as added by 1995, ch. 272, § 2, p. 873; am. 2001, ch. 208, § 19, p. 704.

STATUTORY NOTES

Compiler's Notes.

The bracketed insertions in subsection (2) and paragraphs (3)(a), (3)(b), and (3)(c) were added by the compiler to conform to the statutory citation style.

Effective Dates.

Section 31 of S.L. 2001, ch. 208 provided that the act should take effect on and after July 1, 2001.

Official Comment

1. This section specifies certain rules concerning the rights of persons who purchase interests in security entitlements from entitlement holders. The rules of this section are provided to take account of cases where the purchaser's rights are derivative from the rights of another person who is and continues to be the entitlement holder.

2. Subsection (a) provides that no adverse claim can be asserted against a purchaser of an interest in a security entitlement if the purchaser gives value, obtains control, and does not have notice of the adverse claim. The primary purpose of this rule is to give adverse claim protection to persons who take security interests in security entitlements and obtain control, but do not themselves become entitlement holders.

The following examples illustrate subsection (a):

Example 1. X steals a certificated bearer bond from Owner. X delivers the certificate to Able & Co. for credit to X's securities account. Later, X borrows from Bank and grants bank a security interest in the security entitlement. Bank obtains control under Section 8-106(d)(2) by virtue of an

agreement in which Able agrees to comply with entitlement orders originated by Bank. X absconds.

Example 2. Same facts as in Example 1, except that Bank does not obtain a control agreement. Instead, Bank perfects by filing a financing statement.

In both of these examples, when X deposited the bonds X acquired a security entitlement under Section 8-501. Under other law, Owner may be able to have a constructive trust imposed on the security entitlement as the traceable product of the bonds that X misappropriated. X granted a security interest in that entitlement to Bank. Bank was a purchaser of an interest in the security entitlement from X. In Example 1, although Bank was not a person who acquired a security entitlement from the intermediary, Bank did obtain control. If Bank did not have notice of Owner's claim, Section 8-510(a) precludes Owner from asserting an adverse claim against Bank. In Example 2, Bank had a perfected security interest, but did not obtain control. Accordingly, Section 8-510(a) does not preclude Owner from asserting its adverse claim against Bank.

3. Subsection (b) applies to the indirect holding system a limited version of the "shelter principle." The following example illustrates the relatively limited class of cases for which it may be needed:

Example 3. Thief steals a certificated bearer bond from Owner. Thief delivers the certificate to Able & Co. for credit to Thief's securities account. Able forwards the certificate to a clearing corporation for credit to Able's account. Later Thief instructs Able to sell the positions in the bonds. Able sells to Baker & Co., acting as broker for Buyer. The trade is settled by book-entries in the accounts of Able and Baker at the clearing corporation, and in the accounts of Thief and Buyer at Able and Baker respectively. Owner may be able to reconstruct the trade records to show that settlement occurred in such fashion that the "same bonds" that were carried in Thief's account at Able are traceable into Buyer's account at Baker. Buyer later decides to donate the bonds to Alma Mater University and executes an assignment of its rights as entitlement holder to Alma Mater.

Buyer had a position in the bonds, which Buyer held in the form of a security entitlement against Baker. Buyer then made a gift of the position to Alma Mater. Although Alma Mater is a purchaser, Section 1-201(30), it did not give value. Thus, Alma Mater is a person who purchased a security

entitlement, or an interest therein, from an entitlement holder (Buyer). Buyer was protected against Owner's adverse claim by the Section 8-502 rule. Thus, by virtue of Section 8-510(b), Owner is also precluded from asserting an adverse claim against Alma Mater.

4. Subsection (c) specifies a priority rule for cases where an entitlement holder transfers conflicting interests in the same security entitlement to different purchasers. It follows the same principle as the Article 9 priority rule for investment property, that is, control trumps non-control. Indeed, the most significant category of conflicting "purchasers" may be secured parties. Priority questions for security interests, however, are governed by the rules in Article 9. Subsection (c) applies only to cases not covered by the Article 9 rules. It is intended primarily for disputes over conflicting claims arising out of repurchase agreement transactions that are not covered by the other rules set out in Articles 8 and 9.

The following example illustrates subsection (c):

Example 4. Dealer holds securities through an account at Alpha Bank. Alpha Bank in turn holds through a clearing corporation account. Dealer transfers securities to RP1 in a "hold in custody" repo transaction. Dealer then transfers the same securities to RP2 in another repo transaction. The repo to RP2 is implemented by transferring the securities from Dealer's regular account at Alpha Bank to a special account maintained by Alpha Bank for Dealer and RP2. The agreement among Dealer, RP2, and Alpha Bank provides that Dealer can make substitutions for the securities but RP2 can direct Alpha Bank to sell any securities held in the special account. Dealer becomes insolvent. RP1 claims a prior interest in the securities transferred to RP2.

In this example Dealer remained the entitlement holder but agreed that RP2 could initiate entitlement orders to Dealer's security intermediary, Alpha Bank. If RP2 had become the entitlement holder, the adverse claim rule of Section 8-502 would apply. Even if RP2 does not become the entitlement holder, the arrangement among Dealer, Alpha Bank, and RP2 does suffice to give RP2 control. Thus, under Section 8-510(c), RP2 has priority over RP1, because RP2 is a purchaser who obtained control, and RP1 is a purchaser who did not obtain control. The same result could be reached under Section 8-510(a) which provides that RP1's earlier in time

interest cannot be asserted as an adverse claim against RP2. The same result would follow under the Article 9 priority rules if the interests of RP1 and RP2 are characterized as "security interests," see Section 9-328(1). The main point of the rules of Section 8-510(c) is to ensure that there will be clear rules to cover the conflicting claims of RP1 and RP2 without characterizing their interests as Article 9 security interests.

The priority rules in Article 9 for conflicting security interests also include a default temporal priority rule for cases where multiple secured parties have obtained control but omitted to specify their respective rights by agreement. See Section 9-328(2) and Comment 5 to Section 9-328. Because the purchaser priority rule in Section 8-510(c) is intended to track the Article 9 priority rules, it too has a temporal priority rule for cases where multiple non-secured party purchasers have obtained control but omitted to specify their respective rights by agreement. The rule is patterned on Section 9-328(2).

5. If a securities intermediary itself is a purchaser, subsection (d) provides that it has priority over the interest of another purchaser who has control. Article 9 contains a similar rule. See Section 9-328(3).

Definitional Cross References:

"Adverse claim". Section 8-102(a)(1).

"Control". Section 8-106.

"Entitlement holder". Section 8-102(a)(7).

"Notice of adverse claim". Section 8-105.

"Purchase". Section 1-201(29).

"Purchaser". Sections 1-201(30) & 8-116.

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

"Value". Sections 1-204 & 8-116.

§ 28-8-511. Priority among security interests and entitlement holders. — (1) Except as otherwise provided in subsections (2) and (3) of this section, if a securities intermediary does not have sufficient interests in a particular financial asset to satisfy both its obligations to entitlement holders who have security entitlements to that financial asset and its obligation to a creditor of the securities intermediary who has a security interest in that financial asset, the claims of entitlement holders, other than the creditor, have priority over the claim of the creditor.

(2) A claim of a creditor of a securities intermediary who has a security interest in a financial asset held by a securities intermediary has priority over claims of the securities intermediary's entitlement holders who have security entitlements with respect to that financial asset if the creditor has control over the financial asset.

(3) If a clearing corporation does not have sufficient financial assets to satisfy both its obligations to entitlement holders who have security entitlements with respect to a financial asset and its obligation to a creditor of the clearing corporation who has a security interest in that financial asset, the claim of the creditor has priority over the claims of entitlement holders.

History.

I.C., § 28-8-511, as added by 1995, ch. 272, § 2, p. 873.

Official Comment

1. This section sets out priority rules for circumstances in which a securities intermediary fails leaving an insufficient quantity of securities or other financial assets to satisfy the claims of its entitlement holders and the claims of creditors to whom it has granted security interests in financial assets held by it. Subsection (a) provides that entitlement holders' claims have priority except as otherwise provided in subsection (b), and subsection (b) provides that the secured creditor's claim has priority if the secured creditor obtains control, as defined in Section 8-106. The following examples illustrate the operation of these rules.

Example 1. Able & Co., a broker, borrows from Alpha Bank and grants Alpha Bank a security interest pursuant to a written agreement which identifies certain securities that are to be collateral for the loan, either specifically or by category. Able holds these securities in a clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Alpha Bank's security interest in the security entitlements that Able holds through the clearing corporation account may be perfected under the automatic perfection rule of Section 9-115(4)(c), but Alpha Bank did not obtain control under Section 8-106. Thus, under Section 8-511(a) the entitlement holders' claims have priority over Alpha Bank's claim.

Example 2. Able & Co., a broker, borrows from Beta Bank and grants Beta Bank a security interest in securities that Able holds in a clearing corporation account. Pursuant to the security agreement, the securities are debited from Alpha's account and credited to Beta's account in the clearing corporation account. Able becomes insolvent and it is discovered that Able holds insufficient securities to satisfy the claims of customers who have paid for securities that they held in accounts with Able and the collateral claims of Alpha Bank. Although the transaction between Able and Beta took the form of an outright transfer on the clearing corporation's books, as between Able and Beta, Able remains the owner and Beta has a security interest. In that respect the situation is no different than if Able had delivered bearer bonds to Beta in pledge to secure a loan. Beta's security interest is perfected, and Beta obtained control. See Sections 8-106 and 9-115. Under Section 8-511(b), Beta Bank's security interest has priority over claims of Able's customers.

The result in Example 2 is an application to this particular setting of the general principle expressed in Section 8-503, and explained in the Comments thereto, that the entitlement holders of a securities intermediary cannot assert rights against third parties to whom the intermediary has wrongfully transferred interests, except in extremely unusual circumstances where the third party was itself a participant in the transferor's wrongdoing. Under subsection (b) the claim of a secured creditor of a securities intermediary has priority over the claims of entitlement holders if the

secured creditor has obtained control. If, however, the secured creditor acted in collusion with the intermediary in violating the intermediary's obligation to its entitlement holders, then under Section 8-503(e), the entitlement holders, through their representative in insolvency proceedings, could recover the interest from the secured creditor, that is, set aside the security interest.

2. The risk that investors who hold through an intermediary will suffer a loss as a result of a wrongful pledge by the intermediary is no different than the risk that the intermediary might fail and not have the securities that it was supposed to be holding on behalf of its customers, either because the securities were never acquired by the intermediary or because the intermediary wrongfully sold securities that should have been kept to satisfy customers' claims. Investors are protected against that risk by the regulatory regimes under which securities intermediaries operate. Intermediaries are required to maintain custody, through clearing corporation accounts or in other approved locations, of their customers' securities and are prohibited from using customers' securities in their own business activities. Securities firms who are carrying both customer and proprietary positions are not permitted to grant blanket liens to lenders covering all securities which they hold, for their own account or for their customers. Rather, securities firms designate specifically which positions they are pledging. Under SEC Rules 8c-1 and 15c2-1, customers' securities can be pledged only to fund loans to customers, and only with the consent of the customers. Customers' securities cannot be pledged for loans for the firm's proprietary business; only proprietary positions can be pledged for proprietary loans. SEC Rule 15c3-3 implements these prohibitions in a fashion tailored to modern securities firm accounting systems by requiring brokers to maintain a sufficient inventory of securities, free from any liens, to satisfy the claims of all of their customers for fully paid and excess margin securities. Revised Article 8 mirrors that requirement, specifying in Section 8-504 that a securities intermediary must maintain a sufficient quantity of investment property to satisfy all security entitlements, and may not grant security interests in the positions it is required to hold for customers, except as authorized by the customers.

If a failed brokerage has violated the customer protection regulations and does not have sufficient securities to satisfy customers' claims, its

customers are protected against loss from a shortfall by the Securities Investor Protection Act ("SIPA"). Securities firms required to register as brokers or dealers are also required to become members of the Securities Investor Protection Corporation ("SIPC"), which provides their customers with protection somewhat similar to that provided by FDIC and other deposit insurance programs for bank depositors. When a member firm fails, SIPC is authorized to initiate a liquidation proceeding under the provisions of SIPA. If the assets of the securities firm are insufficient to satisfy all customer claims, SIPA makes contributions to the estate from a fund financed by assessments on its members to protect customers against losses up to $500,000 for cash and securities held at member firms.

Article 8 is premised on the view that the important policy of protecting investors against the risk of wrongful conduct by their intermediaries is sufficiently treated by other law.

3. Subsection (c) sets out a special rule for secured financing provided to enable clearing corporations to complete settlement. The reasons that secured financing arrangements are needed in such circumstances are explained in Comment 7 to Section 9-115. In order to permit clearing corporations to establish liquidity facilities where necessary to ensure completion of settlement, subsection (c) provides a priority for secured lenders to such clearing corporations. Subsection (c) does not turn on control because the clearing corporation may be the top tier securities intermediary for the securities pledged, so that there may be no practicable method for conferring control on the lender.

Definitional Cross References: "Clearing corporation". Section 8-102(a)(5).

"Control". Section 8-106.

"Entitlement holder". Section 8-102(a)(7).

"Financial asset". Section 8-102(a)(9).

"Securities intermediary". Section 8-102(a)(14).

"Security entitlement". Section 8-102(a)(17).

"Security interest". Section 1-201(35).

"Value". Sections 1-204 & 8-116.

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